87-1429

No. .....

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1987

SOUTHWESTERN BELL TELEPHONE COMPANY,

Petitioner,

vs.

ARKANSAS PUBLIC SERVICE COMMISSION, *et al.*,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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QUESTION PRESENTED

Whether a state public service commission's refusal to permit a public utility to recover collectively-bargained wage costs is preempted by the National Labor Relations Act?

LIST OF PARTIES

The only petitioner is Southwestern Bell Telephone Company. The respondents are the Arkansas Public Service Commission; Robert E. Johnston, Commissioner; Patricia S. Qualls, Commissioner; and James W. Daniel, Commissioner.

At the Eighth Circuit Court of Appeals, the Communications Workers of America were permitted to intervene. The union was granted an extension of time for filing a petition for writ of certiorari until February 20, 1988, and it is expected that Communications Workers of America will be filing a petition for writ of certiorari in its own behalf.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The petitioner, Southwestern Bell Telephone Company,[1] respectfully prays that a Writ of Certiorari issue to review the Judgment of the United States Court of Appeals for the Eighth Circuit entered July 29, 1987.

[1]Southwestern Bell Telephone Company is a subsidiary of Southwestern Bell Corporation. Subsidiaries and affiliates of both companies are listed in Appendix E.

OPINIONS BELOW

The Order entered by the Eighth Circuit Court of Appeals denying petitioner's petition for rehearing appears in Appendix A hereto and is not reported in an official reporter. The Opinion of the Eighth Circuit panel is reported at 824 F.2d 672 (8th Cir. 1987) and is also attached hereto as Appendix B. Orders of the United States District Court for the Eastern District of Arkansas were entered on July 18, 1986 and August 4, 1986. These Orders appear in Appendix C and are not reported. The Arkansas Public Service Commission ("APSC") issued a Final Order which is not reported and is also attached hereto as Appendix D.

JURISDICTION

The Judgment of a panel at the Court of Appeals for the Eighth Circuit was entered July 29, 1987. The Eighth Circuit subsequently denied a Petition for Rehearing on September 24, 1987. On December 16, 1987, Associate Justice Harry A. Blackmun entered an Order extending petitioner's time to file a petition for writ of certiorari to February 20, 1988. This Petition has been filed before that date. The jurisdiction of the Supreme Court of the United States is properly invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Ark. Code Ann. § 23-4-201. *Electric, gas, telephone, or sewer utilities—Rate-making authority.*

(a)(1) The Arkansas Public Service Commission is vested with the sole and exclusive jurisdiction and authority to determine the rates to be charged for each kind of product or service to be furnished or rendered by electric, gas, telephone, or sewer utilities in Arkansas.

Ark. Code Ann. § 23-4-103. *Rates, rules, and regulations to be reasonable.*

All rates made, demanded, or received by any public utility, for any product or commodity furnished, or to be furnished, or any service rendered or to be rendered, and all rules and regulations made by any public utility pertaining thereto shall be just and reasonable, and to the extent that the rates, rules, or regulations may be unjust or unreasonable, are prohibited and declared unlawful.

29 U.S.C. § 158. *Unfair Labor Practices.*

(a) It shall be an unfair labor practice for an employer—

(5) to refuse to bargain collectively with the representatives of his employees. . . .

(d) For the purposes of this section, to bargain collectively is the performance of the mutual obligation of the employer and the representative of the employees to meet at reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment, or the negotiation of an agreement, or any question arising thereunder, and the execution of a writ-

ten contract incorporating any agreement reached if requested by either party, but such obligation does not compel either party to agree to a proposal or require the making of a concession: . . .

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STATEMENT OF THE CASE

Southwestern Bell Telephone Company ("Southwestern Bell") is a Missouri corporation which provides local and long distance telecommunications services to customers in the States of Arkansas, Missouri, Kansas, Oklahoma and Texas. Through its interconnections with interexchange carriers and other telephone companies, Southwestern Bell is part of a nationwide network which provides interstate long distance telephone service to customers throughout the United States and, as a practical matter, much of the world. Southwestern Bell provides interstate telephone services which are regulated by the Federal Communications Commission ("FCC"). The FCC has exclusive jurisdiction under 47 U.S.C. § 410 to separate the costs of various facilities between the interstate and intrastate jurisdictions. The rates which Southwestern Bell charges for local and intrastate long distance service within the State of Arkansas are regulated by the Arkansas Public Service Commission ("APSC") under Ark. Code. Ann. § 23-1-101, *et seq.* (1987). Southwestern Bell's nonmanagement employees are represented by the Communications Workers of America ("CWA").[2]

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[2]Since 1940, Southwestern Bell and CWA have bargained over wages and other terms and conditions of employment and have negotiated numerous collective bargaining agreements.

Because Southwestern Bell's existing rates within the State of Arkansas did not provide it with a fair return on its operations within the State, it filed an application with the APSC on July 3, 1984 for a general rate increase. Public hearings on Southwestern Bell's application began before the APSC in February of 1985. In March of 1985, the APSC conducted *in camera* hearings on a proposal by the APSC Staff to disallow almost $7 million in wage and salary expenses. The Staff's recommendation was based on a comparison of the wages and salaries paid to Southwestern Bell's employees in 24 positions with those paid employees in allegedly similar positions with supposedly comparable companies, a great number of which were not unionized. Of the 24 positions arbitrarily selected to be surveyed by the Commission Staff, 13 were nonmanagement, union jobs subject to collective bargaining between Southwestern Bell and the CWA.

Southwestern Bell opposed the Staff's recommendation on a number of grounds, including its comparison of unionized and non-unionized positions. Southwestern Bell also argued, *inter alia*, that the Staff's recommendation interfered with the collective bargaining process in violation of the National Labor Relations Act (the "NLRA").[3]

The APSC issued a Final Order on May 3, 1985. In its Order, the APSC modified the Staff's recommendation to exclude from examination eight management positions. The APSC determined that the Staff's regional salary

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[3]The 1983 Collective Bargaining Agreement in effect at the time of the APSC hearings had been consummated only after extensive negotiations and a three-week strike. The 1983 Collective Bargaining Agreement expired on August 9, 1986.

survey was inappropriate for those eight managerial positions that have nationwide competitive markets. The APSC, however, disallowed a substantial portion of Southwestern Bell's union wage and salary expenses for thirteen nonmanagement positions and three management positions. The Commission determined that the appropriate salary range for these positions would be from 90%-110% of the averaged surveyed wage for each position. The APSC calculated the amount to be disallowed by multiplying the number of incumbents in each of these 16 positions by the average Southwestern Bell wage or salary for the position. The APSC then multiplied each of these products by the percentage which the position allegedly was above the allowable 110% of the average wage or salary, as determined by the Staff survey. The APSC's adjustment for the 13 nonmanagement positions in question resulted in an annual loss to Southwestern Bell of approximately $3 million, as reflected in wages, fringe benefits and tax expenses which the Company was not allowed to include in its cost of service. Southwestern Bell was, in effect, penalized because it was unionized and therefore required to bargain in good faith.

In this Final Order, the APSC also discussed whether the NLRA prohibited its disallowance of wage expenses that were subject to a valid collective bargaining agreement. The APSC concluded that it could refuse to allow Southwestern Bell to recover wage costs which the company was contractually obligated to pay and this would not disrupt the collective bargaining process mandated by federal law. On December 6, 1985, Southwestern Bell filed suit in District Court to set aside the APSC's Final Order. On July 18, 1986, the District Court entered an Order find-

ing that the Commission's action "directly interferes with collective bargaining both past and future" and "is preempted by the NLRA".[4] On appeal to the Court of Appeals for the Eighth Circuit, the District Court's Order was reversed. The Eighth Circuit held that while the APSC's action affected collective bargaining, its effect in this case fell short of the kind of state interference that Congress had intended to proscribe in the NLRA.

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REASONS FOR GRANTING THE WRIT

I.

The Eighth Circuit's Decision That A State Regulatory Agency May Set Customer Rates For Public Utilities Without Regard To Its Effects On Good Faith Collective Bargaining Between The Company And Its Employee Union Is Contrary To The Law Of Federal Preemption As Decided By This Court, And Allows The Type Of State Interference Congress Intended To Prohibit In That Act.

This Court in *Golden State Transit Corp. v. Los Angeles,* 475 U.S. 608 (1986), held that state and municipal regulation is preempted by the NLRA when it interferes with the "free play of economic forces", which is the

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[4]On August 4, 1986, the District Court issued an Order clarifying its July 8, 1986, order to grant Southwestern Bell a $2,853,528 rate increase, on an annualized basis, and to stay its earlier order pending a final decision by the Court of Appeals for the Eighth Circuit. This rate increase would permit Southwestern Bell to recover the union wage expenses which were disallowed by the APSC.

cornerstone of negotiations between management and labor. The NLRA tells an employer with whom it must bargain, what are the mandatory subjects of that bargaining, and when that bargaining must be undertaken. Only then are the parties entrusted with the process, to bargain with whatever traditional economic tools they have available to them. The only restriction upon this "free play" is that the parties must bargain in good faith. That is, unless a state regulator intervenes in the process and requires one of the parties to go to the table with the wage term already fixed.

In direct contradiction to *Golden State Transit,* the Eighth Circuit Court of Appeals in its decision below held that state regulation may interfere with the collective bargaining process if it does not control the terms of the negotiations. This Court in *Golden State Transit* considered and rejected precisely this same application of preemption law.

In *Golden State Transit,* the City of Los Angeles was found to have interfered in the collective bargaining process between Golden State Transit and its employee union. The City Council's decision to condition the renewal of a taxi franchise upon the resolution of a strike between Golden State Transit and its employee union was found to be preempted by the NLRA, which supports and protects the free play of economic forces in negotiations between management and labor.

In similar fashion, the APSC has interfered in the collective bargaining process between Southwestern Bell and the CWA. Rather than taking a seat at the bargaining table, however, APSC has chosen the more nefarious route

of "redlining" the contract, not only after it has been written, but even after it has been in effect for most of its term. Even worse, APSC reached its conclusion that these wages were unreasonably high without any evidence or finding of bad faith or collusive bargaining.

The Court in *Golden State Transit* based its decision on federal preemption principles set forth in *Machinists v. Wisconsin Employment Relations Comm'n*, 427 U.S. 132 (1976). The so-called *Machinists* preemption provides that a particular activity may be protected by the NLRA not only when it falls within the express prescriptions of Section Seven of the Act, but also when the activity is one which Congress intended to be unrestricted by *any* government regulation.[5] *Id.* at 141.

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[5]Lest APSC argues to the contrary, Senator Taft, one of the drafters of the Labor Management Relations Act, explained this intent in debates before the Senate. Said Taft:

> Basically, I believe that [the committee feels], almost unanimously, that the solution of our labor problems must rest on a free economy and on free collective bargaining. The bill is certainly based on that proposition. . . .
>
> * * *
>
> I feel very strongly that so far as possible we should avoid any system which attempts to give to the government this power finally to fix the wages of any man. Can we do so constitutionally? Can we say to all the people of the United States, 'You must work at wages fixed by the government?' I think it is a long step from freedom and a long step from free economy to give the Government such a right. 93 Cong. Rec. 3835-36 (1947) (Emphasis added.)

Senator Taft specifically addressed the regulation of utility wage rates:

> It is suggested that we might do so [fix wages] in the case of public utilities, and I suppose the argument is stronger there, because we fix the rates of public utilities, and we might, I suppose, fix the wages of public utility workers.

(Continued on following page)

Most importantly, the Court in *Golden State Transit* rejected the Ninth Circuit's reasoning in that case, yet precisely the same reasoning was relied upon by the Eighth Circuit in the present case. The Ninth Circuit in *Golden State Transit Corp. v. City of Los Angeles,* 757 F.2d 830 (9th Cir. 1985), "felt that, when the activity regulated is only a peripheral or incidental concern of labor policy, traditional municipal regulation is not preempted." *Golden State Transit,* 475 U.S. at 612. In holding to the contrary, this Court concluded the following:

> The parties' resort to economic pressure was a legitimate part of their collective bargaining process. But the process was thwarted when the city *in effect* imposed a positive durational limit on the exercise of economic self-help.

Id. at 615 (emphasis added, citations omitted).

The Eighth Circuit in the present case held that the APSC decision was not preempted based on the following reasoning:

> [S]tate regulatory bodies seek to control the costs of utilities, a substantial portion of which goes toward paying wages and benefits. We conclude, nonetheless, that the Commission's disallowance of what is deemed to be unreasonably high wage expenses, while

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(Continued from previous page)

> Yet we have hesitated to embark even on that course, because if we once begin a process of the government fixing wages, it must end in more and more wage fixing and finally government price fixing. It may be a popular thing to do. Today people seem to think that all that is necessary to do is to forbid strikes, fix wages, and compel men to continue working without consideration of the human and constitutional problems involved in that process. *Id.*

> perhaps indirectly *affecting* future bargaining strategy, does not control the terms of any particular collective bargaining agreement and does not interfere in any impermissible way with the exercise of collective bargaining rights protected by the NLRA.

824 F.2d at 674 (emphasis added).

It is apparent why the Eighth Circuit determined that the APSC's decision affected the collective bargaining of Southwestern Bell and CWA. The evidence was strong that the Commission's decision did and will continue to have a significant effect on negotiations between Southwestern Bell and CWA. Several factual and expert examples were cited below, not least among them the chilling effect on bargaining, the aura of a "third party" at the bargaining table, and the impetus to seek bargaining concessions in areas other than wages, some of which might prove even more costly.[6] Moreover, simple logic and common sense indicate that future collective bargaining agreements will be affected, even chilled, by the maximum wage rate the APSC is willing to allow Southwestern Bell to recoup in its rates to customers. That is clearly the result intended by the APSC. The APSC has said it will review future wages, but it gives no guidance as to what rules might apply. Instead, it lets the bargaining process continue, even to the point of resort to self-help, and then overturns the process at its whim. It was simply unrealistic for the Eighth Circuit to ignore the substantial effect of the APSC decision on collective bargaining.

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[6]Even in those areas, the Company now must live with the fear that the APSC may later disagree with the results of other agreements on mandatory subjects of bargaining.

Instead of recognizing the obvious effect of the APSC decision on the collective bargaining process, the Eighth Circuit attempted to circumvent *Golden State Transit* by stating that the APSC decision:

> . . . while perhaps indirectly affecting future bargaining strategy, does not control the terms of any particular collective bargaining agreement and does not interfere in any impermissible way with the exercise of collective bargaining rights protected by the NLRA.

824 F.2d at 674. This holding ignores reality. Certainly the APSC intends to control at least one term in the collective bargaining agreement—the wage term. The Court of Appeals' determination that this interference is permissible is also contrary to *Golden State Transit,* which rejected the argument that activity only peripheral or incidental to labor policy is not preempted. This Court in *Golden State Transit* clearly did not hold that in order to be preempted the activity had to control the terms of the collective bargaining, but only that it must in effect impose a limit on the process.

Since the decision in *Golden State Transit,* this Court has approved one instance in which states may indirectly affect the collective bargaining process. *Fort Halifax Packing Co. v. Coyne,* — U.S. —, 107 S.Ct. 2211 (1987). In *Fort Halifax Packing,* the Court held that the states may substantially regulate minimum employment conditions. The Court held that a Maine statute requiring employers to provide severance pay to employees when a plant closes was not preempted by the NLRA. In effect, the Court adopted a *de minimis* rule. The opinion relied upon *Metropolitan Life Ins. Co. v. Massachusetts,* 471 U.S.

724 (1985), which held that the state's establishment of minimum substantive labor standards is not contrary to the intent of the NLRA. The Court stated that "the evil Congress was addressing . . . was entirely unrelated to local and federal regulation establishing minimum terms of employment." *Fort Halifax Packing,* — U.S. —, 107 S.Ct. 2211 at 2222 (citing *Metropolitan Life Ins. Co. v. Massachusetts*). In other words, the state's setting of threshold wage levels did not and should not have any substantial effect upon the processes protected by the NLRA. Had that state set a *maximum* wage level or sought to alter the bargaining positions of the parties, the result, we believe, would have been otherwise.

In the present case, the APSC is clearly not trying to establish minimum labor standards which apply to all employers equally, but is seeking to reduce public utility costs by mandating a maximum wage to a particular employer, arrived at by the APSC independently rather than at the bargaining table. This attempt at cost-cutting through the direct regulation of economic activity stifles the free play of economic forces vital to good faith collective bargaining between Southwestern Bell and CWA. It forces one of the parties to forego the use of one of its economic weapons. The APSC is inarguably acting within an area entrusted to its comparatively broad and proper discretion, but in this instance, by ruling concerning a particular contract wage, it is acting directly contrary to the central purpose of the NLRA; therefore, *Fort Halifax Packing* is clearly not applicable.

The Supreme Court in *Golden State Transit* firmly held that state or local government may not act in such

a manner as to affect directly or indirectly the collective bargaining process between management and labor. The Court in *Fort Halifax Packing* recognized one instance when the state may affect the process: The NLRA does not preempt state laws or regulations which establish minimum employment conditions. It did not, in so holding, carve out a sinecure within which states may act to dictate bargained wage scales, any more than they can grant or withhold state franchises in order to affect the outcome of the bargaining process. The Eighth Circuit's opinion below is, therefore, clearly contrary to this Court's decision in *Golden State Transit,* and is not supported by *Fort Halifax Packing.*

II.

The First, Third And Ninth Circuit Courts Of Appeals Have Also Decided Cases Contrary To The Law Of Federal Pre-Emption As Decided By This Court.

The authority of state governments to set public utility rates in a manner that substantially affects the collective bargaining process should be a matter of great concern to this Court. The NLRA set up a statutory-framework within which a cohesive national labor policy could evolve. This framework included non-regulation of the collective bargaining process so that employers and their unions and employees would be subject to the free play of economic forces in the determination of wages and benefits. The NLRA has served its purpose well. Beginning in the 1930's unions and labor were able to raise their wages commensurate with their contribution and true value under the "free play of economic forces" doctrine. Using similar economic counterbalances, man-

agement has been able to slow and even reduce labor wage rates to align them with market realities. The free play of economic forces has served labor, management, and society well. When a state chooses, as Arkansas has, to regulate the collective bargaining process, that regulation should be scrutinized very closely, as it can easily alter the delicate balance that the NLRA's "free play of economic forces" doctrine has established and continues to preserve.

By reading the decision too narrowly, the Eighth Circuit in its opinion below held that *Golden State Transit* was inapplicable in the present case. The Eighth Circuit based its opinion on the following cases from other Courts of Appeals: *Massachusetts Nursing Ass'n. v. Dukakis,* 726 F.2d 41 (1st Cir. 1984); *Amalgamated Transit Union v. Byrne,* 568 F.2d 1025 (3d Cir. 1977); and *Washington State Nurses Ass'n v. Washington State Hospital Comm'n,* 773 F.2d 1044 (9th Cir. 1985), *cert. denied,* 106 S.Ct. 1637 (1986). Upon close examination, it is apparent that these decisions are also contrary to this Court's holdings in *Golden State Transit* and *Fort Halifax Packing.* In *Dukakis,* the First Circuit incorrectly reasoned that a state statute aimed at restraining increases in hospital costs did not interfere with collective bargaining since the statute affected the labor-management relationship only indirectly through its regulation of the employers' annual gross income. Similarly, the Third Circuit in *Amalgamated Transit Union* held that the Governor of New Jersey could threaten to withdraw state subsidies of private transportation companies that agreed to include unlimited costs of living increases in their collective bargaining agreements. The Third Circuit improperly allowed such interference in the collective bargaining process on the basis that New Jersey had not directly

commanded or prohibited the conduct of third parties, but merely sought to influence private conduct. Under that reasoning, almost no impingement would qualify for preemption. Lastly, the Ninth Circuit in *Washington State Nurses Ass'n* agreed with the reasoning in *Dukakis* and held that a state hospital commission, which has the power to set maximum hospital rates, did not impermissibly interfere with rights protected by the NLRA when its review practices and public announcements undoubtedly were intended to encourage hospitals and unions to minimize costs. The Eighth Circuit's reliance on these cases was clearly improper and in contravention of the holdings of this Court.

III.

The Decision Below, By Departing From Supreme Court Precedent, Places The Petitioner, Who Operates In Several States And Circuits, At Great Risk Of Inconsistent Adjudications.

Although we assert that the Court of Appeals erred in deciding this case, it is not the correction of error alone which leads us to seek this Writ. The issues presented here are far too important to be resolved without consideration by this Court for two reasons: First, this Court's consideration is necessary because of the nature of the issues themselves—that is, determining federal preemption with respect to an Act which does not expressly preempt anything. The courts, then, are left to "spell out from conflicting indications of congressional will the area in which state action is still permissible." *Garner v. Teamsters Union*, 346 U.S. 485, 488 (1953). The states in the Eighth Circuit and the utilities operating within them are entitled to resolution of such conflicts by this Court, so

that there is no risk of conflicting or inconsistent guidance. In an area where there should be little "tension," the Court of Appeals' decision creates impermissible conflict between federal and state jurisdictions.

Second, this is, after all, a case dealing with utility rate-setting which, while decided in the context of one state's direct intervention into the wage decisions of a public utility, has clear implications for all of the public utilities and related unions in the Eighth Circuit, and for rate-making authorities not only in this Circuit but in other circuits where petitioner operates as well. The risk of inconsistent state and/or federal adjudications is simply too great and too costly when viewed in this context. Inconsistent decisions will affect the ability of petitioner and its unionized employees to bargain collectively on a regional basis, and will create a negative and disruptive influence upon the negotiations of unionized utilities generally.

This is, therefore, that exceptional case in which the attention and decision of this Court is required because it presents an issue of grave constitutional dimension (the finely-struck balance between state and federal powers), and of exceptional public importance (with implications reaching beyond the parties, the boundaries of Arkansas, and the geographic limits of one Circuit). While we believe that this Court has ruled straightforwardly and clearly in analogous cases, and therefore that the case for preemption is clear, the Court of Appeals has erroneously decided otherwise.

A. The Decision Below Overlooks Completely the Interstate Nature of the Collective Bargaining Agreement at Issue.

The collective bargaining agreement at issue here was negotiated on a national basis between the Communications Workers of America ("CWA") and Southwestern Bell, rather than on a state-by-state basis. Southwestern Bell operates in the States of Arkansas, Kansas, Missouri, Oklahoma and Texas, and therefore operates in the Eighth, Fifth and Tenth Judicial Circuits. While this regional bargaining does not remove the power of the states to regulate in many areas, it does create extensive and complex problems which were not addressed by the Court below.

Federal law has entirely preempted the subject of collective bargaining between management and union. Under current law, petitioner's hourly employees are a single collective bargaining unit comprised of employees in five states. In the context of this five-state contract, the Arkansas Public Service Commission ("APSC") has applied, after the fact, its state standard to determine selected wage levels. This order operates not only prospectively, to contain future wages, but also finds that current wage scales, in effect pursuant to an existing collective bargaining agreement, are unreasonable. This disallowance impinges upon the multi-state contract. Yet the Court of Appeals' decision does not even address this issue.

In *Allis-Chalmers Corp. v. Lueck*, 471 U.S. 202 (1985), this Court held, in the context of a state-law tort action, that the Labor Management Relations Act preempted a

state claim where resolution of the latter depended upon analysis of the terms of a collective bargaining agreement. Unless federal law governs the claim, said the Court, the terms of those agreements would be subject to varying interpretations, either among states or between the states and the federal government, thus subverting the unified body of labor-contract law. Relying upon *Teamsters v. Lucas Flour Co.*, 369 U.S. 95, 103 (1962), the Court held that the:

> . . . possibility that individual contract terms might have different meanings under state and federal law could inevitably exert a disruptive influence upon both the negotiations and administration of collective agreements.

Allis-Chalmers, supra, at 210.

In a like manner, the very real possibility that one state might find a particular wage-level to be reasonable while another viewing the same agreement might not, and both might disagree with or fail to follow federal labor law principles on bad faith bargaining, presents a risk of disruption that casts doubt upon the continuing viability of regional bargaining for all utilities who operate across state lines. This impedes not only the bargaining process, but also the right of public utility employees to organize and bargain collectively. Faced with this real problem, petitioner is entitled to consideration and discussion of the interstate commerce problem by this Court. No such consideration was forthcoming from the court below.

B. The Court of Appeals Erred in Considering This To Be An Example of Generalized Regulation Only Peripherally Concerned With the NLRA.

The court below explained that it viewed this regulatory effort of the APSC as one of universal application, of only indirect or peripheral concern to the National Labor Relations Act. How it could reach that decision logically, in a case dealing with a commission decision applying to only one utility, is not clear, but in so doing, the court held that *Golden State Transportation Corp. v. City of Los Angeles*, 475 U.S. 608 (1986), was "clearly distinguishable" on its facts. This was error. In the *Golden State* case and the case at bar, both governmental entities had ostensible regulatory authority over the subject matter; both had traditional local interests in mind and disavowed any interest in impinging upon the NLRA; and both directly limited an economic tool or weapon of one of the parties to collective bargaining. With only minor changes, the Supreme Court in *Golden State* could easily have been talking about this case:

> The Act leaves the bargaining process largely to the parties. It does not purport to set any time [or monetary] limits on negotiations or economic struggle . . . . It is concerned primarily with establishing an equitable process for determining terms [including the wage term] and conditions of employment.

Golden State, supra at 616 (citations omitted; bracketed materials supplied).

Petitioner's hourly employees have elected to exercise their federal right to bargain collectively. Under our federal scheme, the APSC could not dictate the terms of the contract in advance. The APSC is now doing indirectly

and after the fact, however, that which it could not do directly. APSC accomplishes this by adopting a state standard for acceptable wage levels. In so doing, the APSC has rendered the contract for these selected terms a nullity. Moreover, now that the Appeals Court has approved the *post hoc* selectivity of the APSC, the finality of future collective bargaining agreements between Southwestern Bell and CWA will be uncertain, not only in Arkansas, but in other states in which Southwestern Bell operates as well. We now have a situation where five states may apply differing state standards to a single contract subject to and controlled by federal law and guidelines.

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CONCLUSION

The District Court correctly held that the NLRA preempted the APSC decision concerning union wage rates because of the decision's effect on the collective bargaining process. The Eighth Circuit determined that the effect was not great enough as to be impermissible, and incorrectly reversed. Petitioner prays that for the reasons stated in this Petition, a writ of certiorari should issue to review the judgment and opinion of the Court of Appeals for the Eighth Circuit.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 86-2100EA

Southwestern Bell Telephone Company, et al,	)	
Appellees	)	Appeal from the United States District Court for the Eastern District of Arkansas
vs.	)	
Arkansas Public Service Commission, et al,	)	
Appellants.	)	

Appellees' petition for rehearing en banc has been considered by the Court and is denied.

Petition for rehearing by the panel is also denied.

September 24, 1987

Order entered at the direction of the Court.

/s/ Robert D. St. Vrain

Clerk, U.S. Court of Appeals, 8th Circuit

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 86-2100

Southwestern Bell Telephone Company, Appellee,	)	
v.	)	Appeal from the United States District Court for the Eastern District of Arkansas.
Arkansas Public Service Commission; Robert E. Johnston, Chairman; Patricia S. Qualls, Commissioner; and James W. Daniel, Commissioner; Appellants.	)	
Communications Workers of America, (Intervenor Below), Appellee.	)	

Submitted: April 15, 1987

Filed: July 29, 1987

Before LAY, Chief Judge, ARNOLD and WOLLMAN, Circuit Judges.

LAY, Chief Judge.

In 1983, Southwestern Bell Telephone Company (SWB or Company) and the Communications Workers of America (CWA) negotiated and signed a three-year labor contract. The contract contained the usual delineation of wages and benefits for jobs included in the bargaining unit. In July, 1984, SWB filed an application with the Arkansas Public Service Commission (Commission) to increase intrastate telephone rates by some $61 million. At hearings on the request, the Commission staff took the position that the Company's wage expenses should be reduced by approximately $7 million because they were unreasonable when compared with expenses for wages and benefits for similar jobs at similar companies in the geographic region.[1] The Company maintained that the Commission was prohibited by the National Labor Relations Act (NLRA) from making adjustments to wages that were the product of collective bargaining. The Commission rejected the Company's position and adjusted downward by some $5 million its wage and benefit expenses for sixteen job positions, thirteen of which were included in the bargaining unit.[2]

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[1]The Commission refused to allow SWB to recover for wage and benefit expenses that exceeded by ten percent the average wage and benefit expenses for comparable jobs at other companies.

[2]Federal Communications Commission regulations require allocation of the Company's expenses between interstate and intrastate operations. In its first order, the Commission failed to allocate any of the wage and benefit costs to interstate operations, thus overstating the amount of the downward adjustment. At a rehearing, the Commission adjusted the wage and benefit allowance to reflect this allocation. The Commission ultimately disallowed $2,596,986 in nonmanagement wages and $256,542 in nonmanagement benefits and payroll taxes. It granted SWB an overall rate increase of $22,957,000.

The Company appealed the Commission's decision to the Arkansas Court of Appeals in July, 1985, raising the question of federal preemption along with the contention that the order was arbitrary and capricious in many other respects. In December, 1985, after oral argument but before the state court had rendered its opinion, SWB filed a petition in federal district court for declaratory judgment and a permanent injunction. In July, 1986, the district court[3] determined that the Commission's actions were preempted by the NLRA. This appeal followed.[4] We reverse.

Abstention

As a threshold matter, the Commission maintains that the district court abused its discretion in failing to abstain from deciding the case because the identical issue was already before the state court of appeals. This argument overlooks our discussion holding in *Middle South Energy, Inc. v. Arkansas Pub. Serv. Comm'n*, 772 F.2d 404, 417 (8th Cir. 1985), *cert. denied*, 106 S. Ct. 884 (1986). Where a challenge to a state regulatory scheme asserts that the proceeding or regulation at issue is beyond the state's au-

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[3]The Honorable George Howard, Jr., United States District Court for the Eastern District of Arkansas, presiding.

[4]Approximately two months after the district court's order, the Arkansas Court of Appeals held that the NLRA did not preempt the Commission's power to deny the wage expenses and affirmed the Commission's order in all respects. *Southwestern Bell Tele. Co. v. Arkansas Pub. Serv. Comm'n*, 18 Ark. App. 260, 715 S.W.2d 451 (1986).

thority, abstention or exhaustion arguments are seldom applicable.[5]

Federal Preemption Under the NLRA

The Commission's appeal centers on the argument that the NLRA does not prevent a state regulatory body from adjusting downward the expenses a public utility may recover for wages and benefits that were the product of collective bargaining. There is no doubt that a tension exists between federal labor laws protecting the collective bargaining process and state laws charging regulatory bodies with the task of assessing the reasonableness of a public utility's expenses, rates, and revenues. A labor organization invariably uses the collective bargaining process to obtain higher wages and better benefits. At the same time, state regulatory bodies seek to control the cost of utilities, a substantial portion of which goes toward paying wages and benefits. We conclude, nonetheless, that the Commission's disallowance of what it deemed to be unreasonably high wage expenses, while perhaps indirectly affecting fu-

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[5]The numerous cases supporting this principle are set out in *Kentucky W. Va. Gas Co. v. Pennsylvania Pub. Util. Comm'n*, 791 F.2d 1111, 1115 (3d Cir. 1986) (citing cases). In these cases the courts of appeals that have addressed the question have found that abstention is inappropriate where preemption is asserted because the jurisdiction of the state to proceed at all is in question. The only case offered in opposition is the Fourth Circuit's opinion in *Aluminum Co. of Am. v. Utilities Comm'n*, 713 F.2d 1024, 1030 (4th Cir. 1983), *cert. denied*, 465 U.S. 1052 (1984), but even there the court acknowledged that abstention under *Burford v. Sun Oil Co.*, 319 U.S. 315 (1943), is inappropriate in cases where the federal government has preempted the field or where there is a direct, facial conflict between state and federal statutes. 713 F.2d at 1030 (citations omitted).

ture bargaining strategy, does not control the terms of any particular collective bargaining agreement and does not interfere in any impermissible way with the exercise of collective bargaining rights protected by the NLRA.

Arkansas law gives the Commission authority to establish reasonable rates to be charged for intrastate public utilities. Ark. Stat. Ann. §§ 73-202a, -204 (Repl. 1979). To set these rates, the Commission establishes the total reasonable cost of providing utility service based on the value of the investment the Company has made to provide the service, plus operating expenses. Operating expenses include labor costs. The Commission determined that certain wage and benefit expenses claimed by the Company were disproportionately high when compared with those at similar companies.[6] It accordingly adjusted downward the salary expenses component of overall operating costs.

The Commission's order has no relation to the substantive portions of the labor contract between SWB and CWA and thus has no relation to the substantive enforcement of the NLRA, a role that Congress has reserved for the National Labor Relations Board (Board). *San Diego Bldg. Trades Council v. Garmon*, 359 U.S. 236 (1959) (state laws intruding on Board's primary jurisdiction to interpret and enforce NLRA are preempted). The Company stipulated that it is not bound by the Commission's determination of reasonable wage expenditures to the extent that it is prohibited from paying the bargained-for wages.

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[6] In its appeal in state court, the Company claimed that the Commission's findings and order were arbitrary and capricious. The court disagreed and affirmed the Commission's order in all respects.

Indeed, SWB concedes that it is bound by the contract to pay these wages. Further, the Board has no authority under the NLRA to review for adequacy the wages and benefits agreed upon in collective bargaining. The Commission's action and that statutory authority upon which it is based have as their only purpose and effect the setting of reasonable intrastate telephone rates in Arkansas. This does not interfere with or supplement the Board's jurisdiction to enforce federal labor legislation or regulate industrial relations.[7]

The Commission's order also is not an intrusion on the economic self-help mesaures available to labor and management that Congress meant to be unregulated. *Machinists v. Wisconsin Relations Comm'n*, 427 U.S. 132 (1976) (state law that curtails or prohibits self-help measures to the extent that it frustrates effective implementation of NLRA is preempted). In *Golden State Trans. Corp. v. City of Los Angeles*, 106 S. Ct. 1395 (1986), the Supreme Court applied *Machinists* preemption in a case

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[7]A typical example of *Garmon* preemption can be found in *Wisconsin Dept. of Indus. v. Gould*, 106 S. Ct. 1057 (1986). In that case, state law barred employers from doing business with the state if they were found by the Board to have violated the NLRA more than five times. The Court applied *Garmon* preemption:

> Because Wisconsin's debarment law functions unambiguously as a supplemental sanction for violations of the NLRA, it conflicts with the Board's comprehensive regulation of industrial relations. * * * The manifest purpose and inevitable effect of the debarment rule is to enforce the requirements of the NLRA. That goal may be laudable, but it assumes for the State of Wisconsin a role Congress reserved exclusively for the Board.

106 S. Ct. at 1062.

where the local Board of Transportation conditioned renewal of Golden State's taxi franchise on settling a labor dispute with union drivers. The Court held that the Board of Transportation's actions interfered with the bargaining process by encroaching upon permissible economic tactics available to the company:

> Golden State was entirely justified in using its economic power to withstand the strike in an attempt to obtain bargaining concessions from the union. * * * [This] resort to economic pressure was a legitimate part of the collective bargaining process. * * * The Act leaves the bargaining process largely to the parties. It does not purport to set any time limits on negotiations or economic struggle. Instead the Act provides a framework for the negotiations; it "is concerned primarily with establishing an equitable process for determining terms and conditions of employment."

106 S. Ct. at 1399-1400 (citations omitted). The Court rejected the city's argument that it was not regulating labor law but instead was exercising a traditional municipal function in issuing taxi franchises. The city's interest in ensuring uninterrupted service to the public by prohibiting a strike by unionized employees did not allow it to restrict an employer's ability, specifically intended by Congress to be unregulated, to resist a strike. *Id.* at 1401.

These operative facts are clearly distinguishable from the facts in this case. Here, the Commission has the authority under Arkansas law to establish intrastate telephone rates. This is not disputed, nor is the Commission's authority to consider the reasonableness of claimed expenses in the ratemaking process. The problem, according to SWB, is that this authority to set rates and protect

the interests of the ratepaying public infringes on the duty under the NLRA of both the Company and CWA to bargain in good faith. When the Commission essentially becomes a third party at the bargaining table, its power of the purse strings invariably affects the parties' negotiations. The Company claims that it would be placed in a "take it or leave it" position with the union in future negotiations if the Commission has the power effectively to veto a wage agreement by denying the Company the funds to pay for it. The Company further maintains that the Commission's action overlooks the complex nature of labor negotiations, the give and take by both parties on many issues, not just wages. It urges that by isolating wages from other bargained-for components of a labor contract, and by further isolating particular jobs, the Commission has ignored the integrated nature of labor negotiations and has interfered with the economic forces that shape the final agreement.

We cannot agree. Nothing in the Commission's order encroaches upon either party's ability to use economic pressure in future negotiations to gain concessions from the other. The Company remains free to resist the union's demands, and CWA may authorize a strike if its terms are not met. Furthermore, the Commission has not vetoed the wage agreement. As we have already pointed out, the Company stipulated that notwithstanding the Commission's order, it is obligated to pay the bargained-for wages. Finally, nothing in the NLRA guarantees that wages agreed upon in collective bargaining will be recovered from consumers, whether the business is regulated or not. This, therefore, is not a case where either *Machinists* or *Garmon* preemption is appropriate.

The First Circuit addressed a similar situation in *Massachusetts Nuring Ass'n v. Dukakis*, 726 F.2d 41 (1st Cir. 1984). In that case, the Nursing Association challenged a Massachusetts law that provided a prosepective method of reimbursing hospitals for their costs. An overall figure of prospective reasonable costs was derived at the beginning of the year by projecting estimates of component costs. The resulting figure was the amount that a hospital was allowed to collect for care provided in a given year to all its patients, whatever the source of payment.

The court held that the statute was not preempted by federal labor laws because it affected the labor-management relationship only indirectly through its regulation of the hospital's annual gross income. *Id.*, at 43; *see also Amalgamated Transit Union v. Byrne*, 568 F.2d 1025, 1029 (3d Cir. 1977) (en banc) (no preemption where governor threatened to cut off state subsidies to any transit company that agreed with a union to include an open-ended cost of living increase provision in its labor contract).[8]

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[8]The dissenters in *Amalgamated Transit Union v. Byrne* distinguished the situation in the instant case from what they considered an impermissible intrusion into the collective bargaining process under the facts of that case:

> [T]here exists a critical difference between a state communicating to all affected parties the extent of finances it intends to grant for carriers' operations and a state communicating that it will not continue its subsidization if the carriers agree with the unions to retain uncapped cost of living clauses in their employment contracts. The former communication presumably does not constitute interference with negotiations over wages and working conditions, as it is not a state attempt "to influence the substantive terms of collective bargaining agreements."

568 F.2d at 1035 (Aldisert, J., dissenting).

The court also examined the implications of an argument identical to the Company's in this case:

> First of all, in any industry the price of whose product or service—such as electric power, telephone, natural gas, or even rent controlled real estate—is regulated, a state would find its regulatory system vulnerable to preemptive attack on the ground that the overall control of price was too inhibiting an influence on collective bargaining. Logic, however, would carry beyond simple price control. Any state or municipal program that substantially increased the costs of operation of a business in a competitive market would be similarly vulnerable to the preemption argument. *Clean air and water laws, selective cutting requirements in forest operations, industrial safety standards, tax increases —all pro tanto hobble collective bargaining in that they constitute part of the universe in which collective bargaining takes place, just as do general prosperity or depression. But they do not add to or detract from the rights, practices, and procedures that together constitute our collective bargaining system.*

726 F.2d at 45 (emphasis supplied); *see also Washington State Nurses Ass'n v. Washington State Hosp. Comm'n*, 773 F.2d 1044 (9th Cir. 1985), *cert. denied*, 106 S. Ct. 1637 (1986) (rejecting preemption challenge to statute authorizing state hospital commission to measure the reasonableness of wage costs as a component of the overall costs recoverable in rates charged).

Conclusion

The Arkansas Commission is charged with the responsibility of setting rates that state telephone users will pay and determining a fair rate of return that SWB may earn. As part of this process, the Commission assesses the Com-

pany's expenses to determine whether they are reasonable. If the Commission finds that they are not reasonable, an issue controlled by state law standards of arbitrariness and capriciousness, then the Commission will not pass them on to consumers in the form of rate increases. We conclude that the Commission's action disallowing recovery of certain nonmanagement wage and benefit expenses does not rise to the level of an impermissible intrusion into or control over the relationship between the Company and CWA. We finally observe, as did the Ninth and First Circuits, that in any regulated industry, myriad governmental decisions, from ratesetting to the imposition of safety standards, undoubtedly will affect labor relations. Any indirect effect of the ratesetting action taken in this case, however, falls short of the kind of state interference with the labor-management relationship that Congress intended to proscribe. The disctrict court's order accordingly is reversed.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS,
EIGHTH CIRCUIT.

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

SOUTHWESTERN BELL TELEPHONE COMPANY — PLAINTIFF

v. No. LR-C-85-832

ARKANSAS PUBLIC SERVICE COMMISSION;
ROBERT E. JOHNSTON, COMMISSIONER;
PATRICIA S. QUALLS, COMMISSIONER;
and JAMES W. DANIEL, COMMISSIONER — DEFENDANTS

COMMUNICATIONS WORKERS OF AMERICA, — INTERVENOR

ORDER

Plaintiff and defendants have filed a joint motion requesting this Court to amend and stay its July 18th order. Intervenor has no objection to their request. After reviewing the July 18th order in light of the motion, the Court finds that the motion should be, and it is hereby, granted. The figure of "$5,155,000" contained in the first and final paragraphs of that order is deleted and the figure of "$2,853,528" is substituted. Furthermore, the order is amended to provide for an injunction granting plaintiff additional revenue requirement in the amount of $2,853,-528 (annualized) effective May 7, 1985, plus interest in accordance with Ark. Stat. Ann. § 73-217(c)(ii) (Supp.

1985). Finally, the Court finds that the injunction contained in the July 18th order, as modified by this order, is stayed pending a decision by the Eighth Circuit Court of Appeals on the appeal of this Court's decision.

IT IS SO ORDERED this 4th day of August, 1986.

/s/ George Howard, Jr.
UNITED STATES DISTRICT JUDGE

This document entered on docket sheet in compliance with Rule 58 and/or 79(a) FRCP on 8/5/86 by N. Johnson.

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

SOUTHWESTERN BELL TELEPHONE COMPANY

v. No. LR-C-832

ARKANSAS PUBLIC SERVICE COMMISSION;
ROBERT E. JOHNSTON, Commissioner;
PATRICIA S. QUALLS, Commissioner;
and JAMES W. DANIEL,
Commissioner DEFENDANTS

COMMUNICATION WORKERS OF
AMERICA INTERVENOR

ORDER

On December 6, 1985, plaintiff filed this complaint seeking a declaratory judgment and permanent injunctive relief with jurisdiction based on 28 U.S.C. §§ 1331, 1332, 1337, 2001 and 2002. Plaintiff asserts the case arises under Art. VI § 2 (the Supremacy Clause); the Pre-

emption Doctrine; 29 U.S.C. §§ 141 *et seq.* (the Labor-Management Relations Act); 29 U.S.C. §§ 151 *et seq.* (the National Labor Relations Act); 26 U.S.C. §§ 3121 *et seq.* (the Federal Insurance Contribution Act); and 29 U.S.C. §§ 1001 *et seq.* (the Employee Retirement Income Security Act). Plaintiff seeks an order enjoining defendants from all further proceedings to enforce the disallowance of $5,155,000 in actual wages, salary, fringe benefit and payroll tax expenses from intrastate rates found to be excessive in Arkansas Public Service Commission (APSC) Order No. 21 filed on May 3, 1985, in Docket No. 84-165-U. Plaintiff further asks for a declaratory judgment that defendants have no subject matter jurisdiction over the wage rates and benefits negotiated regionally in interstate commerce in the absence of a showing that plaintiff failed to bargain in good faith as required under 29 U.S.C. § 158; that interference, directly or indirectly, with the collective bargaining process is unlawful and inconsistent with federal regulation of collective bargaining; and that denial of the recovery of payments of bargained-for pension and benefit amounts is a direct and impermissible interference with federally protected rights in violation of the Employment Retirement Income Security Act (ERISA). Plaintiff argues that the refusal to permit it to recover wage and other related expenses beyond a certain level through rates has effectively let defendants set the wage levels for plaintiff and the Communications Workers of America (CWA) at less than the current 1983 negotiated contract levels and to avoid confiscation of its property will make plaintiff have to go into talks when the current contract expires on August 9th with a possible "take it or leave it" posture. This situation, plaintiff

asserts, forces plaintiff to violate the good faith standard of collective bargaining and also bargain on a piecemeal basis, all which violates the federal law regarding labor relations and the regulation thereof.

Over defendants' objections, CWA was permitted to intervene on April 11th by order finding that CWA had a sufficient economic interest that would possibly be affected by the action and that plaintiff might not be an adequate representative to protect CWA's position. The complaint in intervention filed that same date further alleged jurisdiction under the Contract, Commerce and Equal Protection Clauses of the United States Constitution and pendent jurisdiction over a claim of tortious interference with contractual rights and business expectancies for which no damages were asked. CWA asked for relief in the form of a permanent injunction enjoining defendants from allowing plaintiff to collect as part of its intrastate wage rates, benefits and payroll tax expenses incurred pursuant to a lawful collective bargaining agreement.

Defendants moved to dismiss all the claims of plaintiff and intervenor on the grounds that there was a failure to state a claim upon which relief could be granted; that there was a failure to state a claim upon which relief could be granted; that there was a lack of jurisdiction over the subject matter; that plaintiff has failed to exhaust its administrative remedies; and that this Court should abstain on the principles of comity and federalism. In support of their motions, defendants submitted affidavits and exhibits.

Oral argument was heard on the motions to dismiss on April 25th. The Court, due to the affidavits and ex-

hibits, found that the motions would be treated as motions for summary judgment. Plaintiff and intervenor orally moved for summary judgment at that time. The Court then set a schedule directing the parties to file a stipulation of facts and to comply with the requirements of Local Rule 29 if they were unable to reach a complete stipulation. A discovery deadline of two weeks was also set.

On May 2, 1986, the parties filed a stipulation of facts. These facts are adopted by the Court as the first twenty findings of the Court listed below. The parties also filed separate statements of material fact in conformity with Local Rule 29, briefs, affidavits, responses to the statements and motions to strike certain affidavits. All submissions have now been made and the case is ready for decision. After reviewing the pleadings and the applicable law, the Court makes the following findings:

1. On July 3, 1984, Southwestern Bell Telephone Company (Southwestern Bell or the Company) filed an Application with the Arkansas Public Service Commission (APSC or the Commission) in which the Company requested approval of an intrastate rate increase in the amount of $60,946,000.

2. The Commission is vested, under Arkansas law, with statutory authority to establish intrastate rates and charges for telephone service in Arkansas. Rates and charges for interstate telephone service are subject to the jurisdiction of the Federal Communications Commission (FCC).

3. One issue in this proceeding is whether the APSC's disallowance of certain payroll costs from the Company's intrastate rates is preempted by the National Labor Relations Act (NLRA).

4. Southwestern Bell employs approximately 70,000 employees in the five states of Arkansas, Kansas, Mis-

souri, Oklahoma and Texas. Of those individuals, approximately 50,000 are non-management employees represented by the Communications Workers of America (CWA), a national labor union.

5. Southwestern Bell's non-management bargaining unit employees are paid wages pursuant to collective bargaining agreements between the Company and the CWA. Employee fringe benefits and working conditions are also governed by collective bargaining. The Company's present collective bargaining agreement was negotiated in 1983 and expires on August 9, 1986.

6. Approximately 30% of Southwestern Bell's non-management wages, benefits and payroll taxes are allocated to the interstate jurisdiction pursuant to FCC regulations governing the allocation of such costs. The remaining 70% is allocated to the intrastate jurisdiction, also pursuant to FCC regulations.

7. In written testimony filed before hearings began before the APSC on the Company's Application, the Staff recommended that the Company's non-management wage and management salary expenses be adjusted downward by $6,916,000. Staff also recommended that the five state utility commissions that regulate Southwestern Bell in the states of Arkansas, Missouri, Kansas, Oklahoma and Texas, join together and establish a base year for comparison purposes to ensure consistent regulatory treatment of Southwestern Bell's compensation expenses and establish what the Staff characterizes as "competitive levels" of compensation for ratemaking purposes in all of the states in which the Company operates.

8. Staff's adjustment to the Company's non-management wages and management salaries was based in part on a survey conducted by A. S. Hansen, Inc., a consulting firm employed by the Commission Staff. The Hansen consultants reviewed a list of job titles and descriptions provided by the Company. From this list of approximately 112 positions, Hansen selected 24 job titles that represented positions which Hansen believed might

have counterparts with other companies in Arkansas and for which published compensation data was available.

9. Staff's proposed adjustment was based on the assumption that the 24 positions reviewed by Hansen were representative of all of Southwestern Bell's jobs in Arkansas.

10. In its Final Order, entered as Order No. 21 in Docket N. 84-165-U on May 3, 1985, the Commission found that the twenty-four positions sampled by Hansen were not representative of the Company's entire work force. The Commission also found the competitive market for 8 of the 24 positions surveyed was nationwide and that the Staff survey was, therefore, not an adequate basis for adjusting costs associated with those eight positions. The Commission, however, disallowed some costs associated with the remaining sixteen positions.

11. Thirteen of the 16 positions for which the Commission made an adjustment are bargaining classification positions held by individuals who are represented by the CWA. The wages paid, fringe benefits provided, and working conditions applicable to the employees in these positions are governed by the 1983 collective bargaining agreement. These 13 positions are as follows: Accounting Clerk, Computer Attendant, Central Office Clerk, Data Processing Clerk, Installation/Repair Technician, Operator, Outside Plant Technician, Teller, Service Representative and Drafting Clerk. There are approximately 1105 non-management employees in Arkansas filling these thirteen positions.

12. The Commission's adjustment to Southwestern Bell's wages was derived by taking the average pay for Bell employees in each of the 13 positions and multiplying it by the number of employees in each position. The average Bell position pay was then compared to 110% of the average market pay as determined by A. S. Hansen, Inc. to determine the Bell excess above 110% market and stated as a percent. That percent excess above market was then multiplied times Bell pay for each position to determine the adjustment amount.

13. The effect of Order No. 21 was to disallow a total of $4,627,000 in non-management wage (13 positions) and management salary costs (3 positions) and $528,000 in fringe benefits and payroll taxes from the Company's rates on an annual basis. Order No. 21 failed to recognize approximately 30% of the Company's wage, salary, fringe benefit and payroll tax costs are allocable to Southwestern Bell's interstate operations, pursuant to their Federal Communications Commission's rules governing cost allocations.

14. On June 3, 1985, the Company filed an Application with the Commission for a rehearing of the wage and salary disallowance, *inter alia*, of Order No. 21. By Order No. 26 entered on July 1, 1985, the Commission granted a rehearing on the issue of the jurisdictional allocation of the wage and salary adjustment in Order No. 21. By Order No. 30 entered on December 20, 1985, Order No. 21 was modified to reduce the amount of non-management wage and management salary disallowed pursuant to Part 67 of the FCC rules governing allocation of costs to interstate and intrastate jurisdiction. The effect of Order No. 21, as amended, is to disallow from the Company's Arkansas intrastate revenue requirement $2,596,986 in non-management wage costs and $256,542 in non-management fringe benefits and payroll taxes, and to grant an overall rate increase of $22,957,000. The Commission's actions with regard to these 13 non-management positions and the disallowed costs associated therewith are the subject matter of this action.

15. In determining appropriate charges for intrastate telephone service, the APSC has historically determined the reasonable costs incurred in providing telephone service. In determining the total costs, or revenue requirement, the Commission reviews the numerous expenditures incurred in providing service. The APSC has never, prior to its decision in Docket No. 84-165-U, disallowed from a utility's rates actual wage expenses that were incurred by a utility pursuant to a collective bargaining agreement.

16. Southwestern Bell is not bound by the Commission determination of a reasonable expenditure to the extent that the APSC has not prohibited the payment of any costs, such a contractual wage costs.

17. The APSC, in Order No. 21, stated that Arkansas ratepayers should not be charged intrastate rates incorporating wage levels in excess of a reasonable range of wages in the competitive market. The Commission further prohibits Southwestern Bell from recovering in its intrastate rate $2,853,528 in non-management payroll costs incurred pursuant to a collective bargaining agreement.

18. The APSC arrived at the amount of fringe benefits and payroll taxes applicable to the 13 non-management positions disallowed in Docket No. 84-165-U through a mathematical process by which the amount of fringe benefits and payroll taxes associated with disallowed wage expenses was determined.

19. Southwestern Bell's current collective bargaining agreement was negotiated in 1983. The present agreement will expire in August, 1986. Under the National Labor Relations Act, the Company and the CWA must bargain in good faith with respect to rates of pay, wages, hours of employment and other conditions of employment.

20. The APSC did not intervene in the 1983 wage contract negotiation between the Company and the CWA. The APSC has also not ordered Southwestern Bell or the CWA to take any particular position in any contract negotiation. The APSC's jurisdiction under Arkansas law is limited to the regulation of intrastate rates, quality of service and certain types of utility financing.

21. The statements of material facts submitted individually by the parties are basically argumentative and are not essential to a determination of this controversy.

22. A decision on the motions to strike is unnecessary since the affidavits submitted all seek to answer the ultimate issue for this Court to decide which is whether the defendants' order is in conflict with federal law. Even if

those affidavits are considered by the Court, the Court finds that the pertinent facts to this Court's decision are contained in the May 2nd stipulation.

23. This Court has jurisdiction over this case under the provisions of 28 U.S.C. §§ 1331, 1332 and 1337. There is diversity of the parties in the requisite amount, there is a federal question to be resolved, and there is a controversy arising under the NLRA, LMRA and ERISA.

24. The Johnson Act, 28 U.S.C. § 1342, does not bar this Court from exercising its jurisdiction. Under the Johnson Act, a district court is prohibited from enjoining or restraining the operation or compliance of any order affecting rates of a public utility and made by a state administrative agency when four factors have been met. The first requirement is that jurisdiction be based *solely* on diversity of citizenship or repugnance of the order to the Constitution. Here, as was found above, jurisdiction is not only based on diversity and the preemption doctrine, but is based on the NLRA, LMRA and ERISA. Thus, by its express provisions, the Johnson Act is inapplicable. See, *International Bro'd of Elec Wrkrs, Local U. No. 1245 v. Nev Pub Ser Comm'n*, 614 F.2d 206 (9th Cir. 1980).

25. The Court finds that this case is governed by the recent cases of *Golden State Transit Corp v. City of Los Angeles*, 106 S. Ct. 1395 (1986) and *Wisconsin Dept of Industry v. Gould, Inc.*, 106 S. Ct. 1057 (1986) and the principles of law contained therein.

26. The Supreme Court has articulated two distinct NLRA pre-emption principles. The *Garmon* pre-emption rule from *San Diego Building Trades Council v. Garmon*, 359 U.S. 236, 79 S. Ct. 773 (1959), "prohibits States from

regulating 'activity that the NLRA protects, prohibits, or arguably protects or prohibits' . . . [and] is intended to preclude state interference with the Labor Board's interpretation and active enforcement of the 'integrated scheme of regulation' established by the NLRA [citations omitted]." *Golden State Transit Corp v. City of Los Angeles, supra,* at 1398. The *Machinists* pre-emption rule from *Machinists v. Wisconsin Employment Relations Comm'n,* 427 U.S. 132, 96 S. Ct. 2548 (1976) precludes regulation of conduct that was intended by Congress to be unregulated to allow certain areas "to be controlled by the free play of economic forces [citations omitted]." *Id.*

27. Plaintiff and intervenor primarily argue that defendants' action is pre-empted by the *Garmon* rule, but they also rely on the *Machinists* rule.

28. While *Golden State* involved the *Machinists* doctrine, its discussion of both theories and the scope of *Machinists* is controlling as is the *Garmon* discussion in *Gould.*

29. In *Golden,* the Supreme Court found the city's insistence that the labor dispute that had resulted in a strike had to be settled before ruling on the merits of the employer's franchise application impermissably conditioned a franchise renewal in a way that intruded on the collective bargaining process and, thus the city's action was pre-empted.

30. Applying the stipulated facts to the relevant law, the Court finds as a matter of law that the action of the defendant in denying recovery of the wage rates and benefits negotiated in interstate commerce in the absence of any showing that there was a failure to bargain in good

faith is pre-empted by the NLRA. It is clear that the defendants' action directly interferes with collective bargaining both past and future.

31. In light of this finding that defendants' action is pre-empted by the NLRA and so is unlawful, the Court finds that it is not necessary to address the remaining issues or theories presented by plaintiff and intervenor since the complete relief requested is resolved by the following declaratory judgment and injunction.

Accordingly, the Court concludes that plaintiff and intervenor are entitled to a declaratory judgment that defendants have no authority over the wage rates and other related benefits negotiated in interstate commerce in the absence of a showing that plaintiff failed to bargain in good faith as required by 29 U.S.C. § 158 and defendants are hereby enjoined from further proceedings to enforce the disallowance of $5,155,000 in actual wage, salary, fringe benefit and related payroll expenses found to be excessive in APSC Order No. 21 filed on May 3, 1985, in Docket No. 84-165-U.

IT IS SO ORDERED this 18th day of July, 1986.

/s/ GEORGE HOWARD, JR.
UNITED STATES DISTRICT JUDGE

This document entered on docket sheet in compliance with Rule 58 and/or 79(a) FRCP on 7/21/86 by AW.

APPENDIX D

BEFORE THE
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION OF SOUTHWESTERN BELL TELEPHONE COMPANY FOR AN ORDER ESTABLISHING AND IMPLEMENTING NEW INTRASTATE RATES, TOLLS AND CHARGES APPLICABLE TO INTRASTATE TELECOMMUNICATIONS SERVICE FURNISHED WITHIN THE STATE OF ARKANSAS	)	DOCKET NO. 84-165-U

I. APPEARANCES

For Southwestern Bell Telephone Company: D. D. Dupre, Garry S. Wann, Ronald D. Young, Gary T. Hartman, T. Michael Payne, and Timothy Brewer.

For the Staff of the Arkansas Public Service Commission: Arthur Stuenkel, Lee McCulloch, Mary Cochran, and W. W. Elrod.

For the Attorney General: William M. Mann, III.

For AT&T Communications of the Southwest, Inc.: N. M. Norton, Jr., Gregory Jones, and Paula Fulks VonderHaar.

For the Secretary of Defense: William J. Dooley, Jr.

For General Telephone Company of the Southwest, Inc.: Michael C. O'Malley, and William C. Ballard.

For the Arkansas IntraLATA Toll Pool: Hermann Ivester.

II. HISTORY

This proceeding began on July 3, 1984, when Southwestern Bell Telephone Company filed an application requesting approval of an intrastate rate increase of $60,946,000. The proposed tariffs and rates were suspended by Order No. 1 on August 1, 1984.

The Office of the Attorney General, Consumer Utility Rate Advocacy Division, (Attorney General) filed a letter of intent to be an active party in this case on July 27, 1984. Applications to intervene were filed by AT&T Communications of the Southwest, Inc. (AT&T Communications) on September 17, 1984; General Telephone Company of the Southwest (General Telephone) on September 24, 1984; GTE Sprint Communications Corporation (GTE Sprint) on October 10, 1984; Secretary of Defense on December 4, 1984; Arkansas IntraLATA Toll Pool (AITP) on January 11, 1985; and the Communications Workers of America (CWA) on January 12, 1985. All of the applicants were granted intervention except GTE Sprint (intervention denied by Order No. 9; December 31, 1984) and the CWA (request for intervention withdrawn on January 21, 1985). General Telephone was granted limited intervention only on the issues of toll rates and access charges. (Order No. 3; November 5, 1984.)

Staff, the Attorney General, and Southwestern Bell Telephone joined in a Motion to Transfer filed January 15, 1985, asking that the access charge issue be transferred to Docekt No. 83-042-U. AT&T Communications opposed this motion. The motion was granted on January 31, 1985, by Order No. 14. AT&T Communications petitioned for

rehearing and reconsideration of the transfer. This petition was denied from the bench during hearings. (T. 147).

As originally filed, the test year data was made of six months historical data (September 1, 1983, through 29, 1984) and six months projected data (March 1, 1984, through August 31, 1984). (T. 335). At the time he filed rebuttal testimony on January 30, 1985, Mr. W. W. Lampkin, Southwestern Bell Telephone's chief accountant, had available historical data for the full test period. As part of his rebuttal testimony, Mr. Lampkin modified his original exhibits to substitute the historical data. (T. 348). The change to fully historical data lowered the net revenue deficiency from $60,946,000 (Lampkin Exhibit 1) to $51,928,000 (Lampkin Exhibit R-1). This data was provided to Staff during their audit and was used by them in calculating their recommended revenue requirements. (T. 495-496).

The hearings commenced on February 12, 1985. (See Order No. 4; November 15, 1984). During the hearings all issues identified by Order No. 16 were addressed except for the wage and salary issue. This issue was postponed pending settlement of discovery disputes. (Order No. 20).

We have considered very carefully the issues raised and the positions of the seven parties as presented in the written and live testimony and exhibits of the witnesses, in the cross-examination of the witnesses, and in the briefs. In this Order, we will set forth our decisions on those issues and the reasons for those decisions.

III. JURISDICTION

The Commission has jurisdiction over this matter pursuant to Ark. Stat. Ann. § 73-217 (1979 and Cum. Supp. 1983).

IV. TEST YEAR

The test year is the twelve month period used in determining the rate base, operating income, and rate of return. In this proceeding the test year is September 1, 1983, through August 31, 1984. (T. 335). The *pro forma* year the twelve month period following the end of the test year (adjusted for known and measurable changes), is September 1, 1984, to August 31, 1985. (T. 335). The Company and Staff recommended we adopt this test year and *pro forma* year. (T. 496). We find those test and *pro forma* years are reasonable.

The test year used in this case included four months prior to the divestiture of Southwestern Bell Telephone from the Bell System. The data from those months, September through December, 1983, were not representative of Southwestern Bell Telephone's operations after divestiture. Accordingly, both Southwestern Bell Telephone and Staff made adjustments to exclude the pre-divestiture data. (T. 335, 496).

V. RATE CASE METHODOLOGY

The revenue requirement of a utility may be expressed as the total dollar amount of the company's cost of service. The cost of service of a utility is composed of operating expenses (including depreciation expense and taxes) plus the dollar amount of return on the company's

rate base. The rate base is the gross value of the property serving the public less accumulated depreciation reserves. A percentage rate of return on rate base is determined by the weighted cost of all components of the company's capital structure, such as equity, preferred stock, long-term debt and, where applicable, short-term debt. The rate base is multiplied by this percentage and the product (the return) is added to the operating expenses to yield the revenue requirement.

The revenue requirement is based on a 12-month historical period or "test year", as adjusted for known and measurable changes. In order to determine the amount of increase or decrease in revenue to which the company is entitled, the return received by the company during the test year is subtracted from the return component of the revenue requirement. It is this difference, multiplied by an appropriate factor for taxes and uncollectibles in the case of investor-owned utilities, which represents the increase (or decrease) in revenues to be produced by the new rate schedules.

VI. RATE OF RETURN

Testimony with regard to the appropriate rate of return for SWB was presented by Mr. Michael Kaufman on behalf of SWB. Mr. Richard Wilson on behalf of the Attorney General, Ms. Donna Kilburn on behalf of the Staff, and Mr. Mark Langsam on behalf of the Department of Defense. Although the prefiled testimony of Mr. Langsam was apparently never formally admitted into the record, our examination of the transcript (T. 990 ff) indicates that this omission was a mere oversight. Additionally the

record indicates that all parties agreed to waive cross-examination of Mr. Langsam. Further evidence of the clear intent of all parties to waive cross-examination of Mr. Langsam is found in Staff Attorney Lee McCulloch's February 26, 1985, letter to the Commission attached hereto as Appendix C. Therefore, in light of the clear intent of all parties as indicated above, the prefiled testimony and exhibits of Mr. Langsam are hereby incorporated into and made an official part of the record of this cause.

The basic aim of regulation is to set prices which allow the utility to recover its expenses as well as an opportunity to realize a reasonable rate of return on its investment. This section of the Order discusses the process of determining the reasonable rate of return. The determination by the Commission of the reasonable rate of return is a four step process. The first step is to determine the appropriate rate base as well as the appropriate capital structure of the utility. The capital structure is the source of funds used to finance the company's investments. The second step is to determine the company's cost of debt. Because the cost of that debt is set by the contractural terms of the debt issue, this step is relatively noncontroversial. The third step is to compute the company's just and reasonable cost of equity. This cost of equity is the return shareholders should begin an opportunity to earn on their common stock investment. The determination of the just and reasonable cost of equity is usually the most controversial step in the process. The fourth step is to compute the overall allowed rate of return for the utility. This is purely a mechanical step. The principal dispute in determining the cost of capital is invariably the dis-

agreement between consumer advocates and the utility over the cost of equity. This case is no different. This case also contains a major dispute between the PSC Staff and the Company, joined by the Attorney General, over the issue of what should be appropriately included as cost free funds in the capital structure. The other issue is a proposal by the Department of Defense to use a hypothetical capital structure. The Department of Defense alleges that the overall cost of capital for the actual capital structure of the company is too high, and that ratepayers would have received more benefit had the company chosen a more optimal mix containing more debt, which has a lower cost than equity, and less equity.

A. *Cost of Equity*

To set the comparative historical scene, this Commission and its predecessor has set the authorized Return on Equity (ROE) for SWB at 13.0% and 13.16% in the last two rate cases, i.e. 13.16% in 1982 in Docket No. 82-037-U and 13.0% in January of 1984 in Docket No. 83-045-U.

This Commission, as well as many other regulatory commissions has in the past expressed some preference for the Discounted Cash Flow (DCF) method of calculating the cost of equity, supplemented perhaps by other methods. Other methods are often used to verify that the results of the Company specific DCF method are valid. Other methods include examining the ROE of risk-comparable firms (e.g. other Bell companies or independent telephone companies) or some version of the risk premium approach. Each of the witnesses in this case utilized the DCF company specific market value approach and supple-

mented their findings with other methods. We will examine each of these in turn.

1. *The Discounted Cash Flow (DCF) Method*

The determination of the fair and just (ROE) is not an exact science, or a mechanical calculation but a judgment of what is fair and reasonable, based on the evidence. The DCF formula is as follows:

ROE = D/P + g (+ flotation costs + dilution effects, if any). The formula is dependent on the measurement of variables that change over time, as well as estimates. There is little dispute over dividends (D), although some witnesses seek to *project* future dividends which leads into the difficulties of trying to determine whether the projections are reasonably known and measurable as required by Arkansas statute.

A greater problem is in determining the price (P), since stock prices tend to fluctuate from day to day and even from hour to hour. Witnesses tend to average closing prices over some time period or even to average highs and lows over some period. Utility witnesses sometimes seem to choose time periods for stock prices which result in a higher cost of equity and consumer representatives sometimes seem to choose time periods and consequent prices which result in a lower cost of equity. Here, more so than in determining a dividend, witnesses tend to present a *range* of prices, and consequently a range of yields (Yield = D/P).

However, the problems of recommending ranges of values from which regulators can exercise reasoned judgment pales in comparison with the practice of witnesses recommending values for g, the *future* growth component

of the DCF formula. Since g is not directly measurable, surrogates or estimates are presented and hotly disputed.

The DCF formula is based on an essential and integral assumption that there is one, long term, sustainable to infinity, growth rate in stock price and dividends and inevitably, therefore, in earnings per share and book value per share. The DCF method is based on the assumption that all financial variables of a utility grow at the same rate from distant past to distant future. That actual growth rates vary among the variables i.e., dividends, earnings per share, and book value in any one year and certainly vary from year to year points out the approximation character of the DCF formula. Yet the assumption that there is a constant, sustainable, long term growth rate is necessary in order to have a manageable way to approximate the growth in capital gains and growth in dividends which reasonably can be expected by stockholders. This is true because the DCF approach begins with the assumption that the fair market price of a stock reflects the knowledge of a perfectly competitive stock market, where all potential purchasers of stock are equally informed as to the probable dividend flow, and that the discount rate in the income stream necessary to go from a stream of yields back to a stock price is the present ROE. In order to solve the following equation we must assume that the growth (k) is constant to infinity:

$$P = \frac{D1}{1+k} + \frac{D2}{(1+k)^2} + \frac{D3}{(1+k)^3} + \cdots + \frac{Dn}{(1+k)^n}$$ where n = infinity.

Regulatory commissions have been plagued since rate of return regulation began in attempting to deal with projections. Most regulatory commissions, as well as the Arkansas legislature, have chosen to accept only what is

"known and measurable" i.e., readily verifiable as actual fact, through the use of accounting data, rather than relying on expert witnesses who greatly differ with each other in their projections. Such projections are notoriously less accurate than past measurements.

Some explanation is helpful of why *in the long run,* sustainable growth rates of dividends per share (DPS), earnings per share (EPS), and book value per share (BVPS) must be the same. Dividends per share are a policy decision of corporate directors. There is a strong tendency to maintain a constant rate of growth in dividends and to *cut* dividends only in dire circumstances. If earnings per share do not increase as rapidly as dividends per share, dividends will eventually surpass earnings.

For all of the foregoing reasons, witnesses tend to disagree and also to present a range of figures for each of the variables in the DCF formula and, in fact, a range for their other corroborating analyses as well. It is worthwhile to examine those differences and ranges in some detail and to dissect the reasonableness of each of them. The table on the following page shows the components of the DCF formula for the witnesses and the Commission's findings.

DISCOUNTED CASH FLOW (DCF) COMPONENTS

	1 Dividend D	2 Price P	3 Yield=D/P Col 1—Col 2	4 b Retention Ratio	5 r	6 g=br Col 4—Col 5	7 Barebones DOE= yield+g Col 6+Col 3	8 Flotation	9 DOE= Barebones + Flotation Col 7+Col 8
Kaufman (SWB)	5.60[13] 5.80-6.05 (5.93)[1]	(55-59)[2] "Mid-Upper 50's"	9.5-10	.35-.40[3]	14-15[4]	5-7[5] (6) 4.90-6	15.5-16.0 13.4-16.0	0.50[6]	16.-16.5 13.90-16.5
Langsam (DOD)			8.2-9.2		5.1-5.6		13.3-14.8	0.0	13.3-14.8
Kilburn (PSC Staff)	5.60	59.4-61.9[7] (60.7)	9.0-9.4 9.22	.35-.40	12.5-13	4.05-5.05[8]	13.05	0.03	
Wilson (AG)	5.60 —6	68.5[9]	8.18-8.75	.35-.40	14.65[11]	5.0-5.5[14] (5.25)		0.05[12]	
Commission	5.60	68.5-74.75[10]	7.50-8.18	.35-.40	12.5-13.0	5.12-5.86 4.375-5.2	11.875-13.38	0.03	11.905-13.41

1 T. 466
2 T. 853
3 T. 855
4 T. 856
5 T. 858
6 T. 897
7 T. 562
8 T. 565, T. 1092
9 T. 1002
10 T. 936
11 T. 536
12 T. 537
13 T. 853
14 T. 1001

Elements of the DCF components and Commission findings of fact:

a. *Dividends*

The witnesses generally agree on this element. We find the only evidence in the record for the actual annual dividend is $5.60 per share.

Mr. Wilson and Mr. Kaufman both present evidence of *projections* by various experts. The projections in the record vary from $5.60 to $6.05. (Kaufman Rebuttal Ex. 1, page 3). The Commission continues its preference to rely on *historical* data rather than estimates or projections.

b. *Price*

This is one of the widest areas of disagreement among the witnesses with Mr. Kaufman using a range of 55-59, Ms. Kilburn using a range of 59.4-61.9 with an average of 60.7, and Mr. Wilson using a figure of 68.5. Mr. Langsam does not report P, merely the resultant yield (although working backward the required P's are 60-68).

The principal differences among the witnesses are in the time periods reported. Ms. Kilburn's figures show a definite upward trend in P. See Ex. Dk-3. We find Mr. Wilson's figures most persuasive in that they were based on the most recently available stock price. Further, we find in the record that the P in December, 1984, was 71.5 (T. 1006), and that the P as of February 19, 1985, was approximately 74.75 (T. 936). Therefore, we find the best evidence of P is a range of Mr. Wilson's 68.5 and the most recent figure in the record of 74.75. (T. 936). (In support

of the reasonableness of this finding we take administrative notice of the fact that SWB's stock has continued to trade in the mid 70's in April of 1985 and as of April 25, 1985, SWB stock closed at 76¼ and on April 26, 1985, it closed at 77 7/8. We also note that the dividend moved to $6.00.)

c. *Yield*

Therefore, we find the yield (Yield = D/P to be in the range of 7.50-8.18%.

d. *Growth*

All witnesses chose to estimate growth by some version of the "br" method where b = the retention ratio (Retention = 1 - pay out ratio) and r = the investor-expected earned ROE. There is no disagreement among witnesses about b (the retention ratio), therefore, we choose to follow the uniformity of the recommendations and use 35-40%. The principal disagreement among witnesses is in the r (investor expected ROE). This is in fact the greatest disagreement among witnesses in the entire DCF-ROE dispute.

Mr. Kaufman suggests that investors expect to earn the *allowed* ROE and thus a range of 14-15% in his choice. (T. 856). Mr. Wilson adopts a similar approach and suggests the *maximum* "r" is 14.65% (the composite allowed equity return for SWB) and then recommends the maximum be utilized as the expected.

Mr. Langsam has found the actual ROE for SWB for the first three quarters of 1984 to be 13.2% (filed testimony ML 37) and further recommends:

> The cost of equity for the Company is lower than the cost of equity for Southwestern Bell Corp. because the Company will provide regulated services while Southwestern Bell Corp. will be entering competitive markets for the provision of customer premises equipment and other telecommunications services. Therefore the Company's cost of equity must be based on the lower end of the range, 13.3% to 14.0%. (filed testimony ML 38).

Ms. Kilburn's evidence suggests that investors expect the long run sustainable growth rate to be 12.5-13.0 based on historical records of AT&T and the divested Bell Companies in 1984 on present evidence.

We find the use of Mr. Kaufman and Mr. Wilson of the *allowed* ROE to be unpersuasive for the following reason:

Earned ROE generally tends to be less than *allowed* ROE. This is true because of (among other things):

a. Regulatory lag and inflation.

b. Managerial and other inefficiencies.

c. Changes that are not reasonably known and measured.

d. Some expenses (e.g., charitable contributions, advertising, etc.) are "below the line" and not allowed for rate making purposes as chargeable to ratepayers.

Rate of return ratemaking does not guarantee a ROE . . . it only permits an opportunity to earn an ROE similar to that of firms of like risk. That there is a divergence between *allowed* ROE and *earned* ROE is demonstrated in Staff-Kaufman Cross Examination, Exhibit 1. The data is displayed on Appendix A attached hereto.

For 7 of the 9 years *earned* ROE was less than *allowed.* On an average over 1975-1983 the earned ROE was 2.0% less than that allowed.

If earned and allowed ROE's were equal, the points would all lie along the 45° line. That is obviously not the case and there is no historical pattern that actual ROE is now approaching allowed ROE moreso than in the past. Further, not only is there not a perfect correlation (Correlation Coefficient = 1.0) between earned and allowed ROE's, there is a negative correlation (Correlation Coefficient of -0.21).

In this case SWB's rate of return witness, Mr. Kaufman relied on the projections of analysts as to the probable growth rate of SWB's DPS, EPS, etc. All other witnesses disputed that approach. This Commission has in the past tended to discount projections in general. As most regulatory commissions we find reliance on past historical data to be much more "known and measurable." This is even more warranted in instances where the relationships between the analysts and the utility being evaluated are not in all instances arms length relationships. This situation is discussed in the testimony of Dr. Myron Gordon. Dr. Gordon's testimony before the FCC was submitted by SWB to justify their ROE figures. (Kaufman AG. Ex. 1). The Attorney General submitted earlier testimony of Dr. Gordon pointing out serious doubts about accepting the "independent" projections of stock market analysts as realistic known and measurable future growth rates of a company. Dr. Gordon's testimony is worth quoting at some length:

> Another method for estimating the expected rate of growth in a company's dividend, earnings, and price

is to ask the members of the investment community whose job it is to make forecasts, i.e., the security analysts for investment advisory services, mutual funds, pension funds and other such organizations. However, this method poses serious problems. *When such estimates are obtained in response to a request by a company, there is danger that consciously or unconsciously the estimates provided will be tailored to suit the desires of the company.* This is particularly true if *the estimates were requested at one or more earlier times for the same purposes, since the company and the security analysts have a community of interest.* Even if each estimate provided is not biased upwards, the average estimate is, insofar as analysts who forecast a low rate of growth will decline to provide their estimates.

Estimates that are provided to the general public by investment advisory services without regard for their use in the regulatory determination of share yield are *also highly questionable.* These services tend to put *out considerably more buy recommendations than sell recommendations.* Furthermore, their buy recommendations are categorical with specific reasons given, while their sell recommendations can, for the most part, only be inferred from statements that damn with faint praise. As a consequence, analysts who do not periodically publish growth estimates on a fixed, unchanging, overtime list of stocks will publish estimates on stocks that they judge to have favorable growth prospects, simply passing over stocks on which they are bearish. Hence, *an average of the published estimates will tend to be biased upwards.* (Emphasis added). (M. J. Gordon; Kaufman AG. Ex. 1).

Further we note that a survey of major investment firms as an argument for higher costs of equity has been rejected by the previous Commission in Docket No. 82-037-U:

> We believe that to . . . accept the proposition of Mr. Kaufman's that the actual projection of expected return on book equity should be based on the opinion of institutional investors is equally unsatisfactory. To follow Kaufman's recommendation would mean that investors would dictate their own return. (Order No. 11, at 15-16)".

It may or may not be realistic for SWB's *earned* ROE in 1985 to approach more closely the allowed ROE. However, it is certainly not realistic for investors to expect it to reach 14.65% based on past historical evidence. Therefore, we reject Mr. Kaufman's 14-15 range and Mr. Wilson's 14.65% figure.

We find Ms. Kilburn's use of historical data for AT&T and SWB to be reasonable as to expectations by investors of future growth in EPS for SWB. AT&T was primarily a collection of local telephone companies in its earnings stream in past years. The evidence of 1984 performance of SWB and the other Regional Bell Holding Companies does not cause us to doubt that EPS will be in the range of 12.5-13. Therefore we find that r = 12.5-13 and the consequent g = 4.375-5.2.

e. *Flotation*

Mr. Langsam recommends no flotation or dilution adjustments. (Filed testimony ML-48). Ms. Kilburn recommends a 0.03% adjustment, Mr. Wilson a 0.05% adjustment and Mr. Kaufman a 0.50% flotation adjustment. (T. 897). Needless to say, Mr. Kaufman's adjustment received considerable attack on cross-examination as unwarranted and far greater than any ever allowed by this Commission. A .50% adjustment is simply not supported by the evidence.

Mr. Wilson points out that with an equity ratio of 55% there will probably be no new common equity issuances in the near future. (T. 1002).

Therefore, we find that the preponderance of evidence indicates a flotation cost range of 0-0.05%. We accept as reasonable a flotation adjustment of 0.03.

f. *Commission ROE DCF Method*

The combined foregoing elements yield the following computation in the DCF equation:

$$\begin{aligned} \text{ROE} &= \text{Yield} + g + \text{flotation} \\ &= (7.50\text{-}8.18) + (4.375\text{-}5.2) + 0.03 \\ &= 11.905 - 13.41 \end{aligned}$$

2. *Other ROE Methods*

As indicated above, most witnesses presented a range of figures for a just and reasonable ROE and then often recommended a single figure in that range which is usually, but not always, the midpoint, (e.g., Mr. Langsam recommended the lower part of the range).

Further as indicated above, most witnesses supplemented their DCF proposal with other methods to verify the DCF method and to demonstrate that the DCF method is supported by other approaches.

The table below indicates the ROE ranges of the several witnesses and the Commission calculations of what is a just and reasonable ROE resulting from the choices of variables most supported by the evidence.

	(Mkt. Value) DCF (Co. Specific)	Risk Comparable Bell R.H.C.	Risk Comparable Companies [Indep T.C.]	Risk Premium	Commission Decision
Kilburn	13.36-14.39 (13.88)	13.76	13.51		
Wilson	13.73-14.31 (14.02)	14	14 14.31		
Langsam	13.3-14.0 (13.65)	13-14	13.5-14	14.1-14.5	
Kaufman	16.0-16.5 (16.0)				
Commission	11.90-13.41				*13.5*

When we consider the ranges recommended by the various witnesses and the overlap with our own DCF calculation, we find the ROE which is just and reasonable for SWB and which is substantially supported by the evidence to be *13.5%*.

B. *Capital Structure*

The recommended capital structure of each of the witnesses is listed on the next page.

Langsam (DOD) Southwestern Bell Telephone Company
Cost of Capital

	Percent	Cost	Weighted Cost
Senior Securities	50	9.39%	4.70%
Common Equity	50	**	**

Common Equity	Total Cost of Capital
13.50%	11.4%
14.00	11.7
14.50	12.0

Kaufman (SWB) Kaufman Rebuttal Exhibit I, Pg. 1

Southwestern Bell Telephone Co. Actual Capital Structure & Related Costs
As of August 31, 1984

	Percent	Cost	Weighted Cost
Common Equity	55.38%	16.0%	8.86%
Debt	44.62%	9.5%	4.24%
	100.00%		13.10%
			X 85.19%*
			11.16%

*Adjustment to reflect 14.81% of Arkansas Intrastate rate base attributable to deferred taxes and pre-1971 unamortized investment tax credits as of August 31, 1984. (100% less 14.81%= 85.19%)

Wilson (AG) Cost of Capital (As of September 1984)
Exhibit RSW-6

Component	$ Amount (000's)	Ratio	Cost	Weighted Cost
Common Equity	$ 6,610,715	.55492	.14020	.0777998
Total Debt	5,298,349	.44476	.09501	.0422566
Cust Deposits	3,828	.00032	.06000	.0000192
TOTALS	$11,912,892	100%		.1200.756
				X .8519*
				.1022924
				10.23%

*Adjustment to reflect 14.81% of intrastate rate base attributable to deferred taxes and pre-1971 Accumulated Deferred Investment Tax Credits

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Kilburn — Revised Exhibit DK-15

Southwestern Bell Telephone Company Overall Cost of Capital
(Total Company)

Component	Amount	Proportion (%)	Cost	Weighted Cost
Long-Term Debt	$ 4,970,984,484	34.82	9.38	3.27

Short-Term Debt	298,917,875	2.09	10.44	.22
Common Equity	6,549,137,000	45.88	13.75	6.31
Customer Deposits	70,446,991	.49	6.35	.03
Accumulated Deferred Income Taxes	2,373,994,287	16.63	0	0
Pre-1971 Investment Tax Credits	12,229,751	.09	0	0
TOTALS	$14,275,710,388	100.00		9.83

The proposed capital structures are arranged from least to most complicated and will be discussed in that order:

1. Mr. Langsam suggested that the proper regulatory treatment is to calculate the cost of capital as though SWB had 50% debt and 50% common equity. This is predicated on the observation by Mr. Langsam that equity has a higher cost than debt and that SWB has a substantially higher percentage of equity than other regulated utilities; ergo, SWB could reduce the cost of capital by issuing debt and retiring equity. If SWB chooses to be less leveraged, that higher cost of capital should not be passed on to the ratepayers, according to Mr. Langsam.

2. Mr. Langsam and Mr. Kaufman do not include Customer Deposits in the capital structure. Mr. Wilson and Ms. Kilburn follow the past practice of this Commission in finding that Customer Deposits are part of the source of capitol, akin to long-term debt.

3. Mr. Kaufman and Mr. Wilson make an adjustment to reflect the 14.81% of intrastate rate base attributable to accumulated income taxes and to pre-1971 In-

vestment Tax Credits, which are zero-cost sources of investment funds, which are permitted under U. S. Internal Revenue statutes to be flowed through to the benefit of ratepayers.

4. Ms. Kilburn, along with Mr. Wilson, includes customer deposits, but makes a different inclusion in the Accumulated Deferred Income Taxes and pre-1971 Investment Tax Credits. Her reasoning is that just as company-wide (i.e. for a multi-state region) amounts are used for debt and equity (in that bonds and stocks are sold on a company-wide basis and not specifically tied to investment in Arkansas) that accumulated deferred taxes and ITC's should also be considered on a company-wide basis.

Commission Finding on Issues Involved in the Capital Structure:

A. Customer Deposits

Based on the preponderance of evidence in this docket and following past Commission practice, we find that customer supplied deposits are closely akin to debt obligations of the company and should be therefore, included in the capital structure.

B. Disallowance of Capital Costs for Equity over 50% (So called "Hypoethical Capital Structure")

As proposed by Mr. Langsam, there is substantial evidence to adopt this position, yet not sufficient and substantial evidence as to whether the overall cost of capital to ratepayers would be diminished if SWB indeed moved to reduce its equity ratio. We reserve judgment on this approach until further evidence is presented, either on

rehearing or in a future rate case. We note, however, that the "hypothetical capital approach" is not unique to this case, having been adopted in other jurisdictions and adopted by this Commission with respect to Arkansas Oklahoma Gas Company, which also had a high equity ratio.

C. Proper Treatment of Accumulated Deferred Income Taxes and Pre-1971 Investment Tax Credits

The primary capital structure issue was whether total Company zero-cost capital components or Arkansas only capital components should be included in the overall rate of return calculation. All four witnesses either deducted from rate base or included in the capital structure the zero-cost capital components: accumulated deferred income taxes (ADIT) and pre-1971 unamortized investment tax credits (ITC). Mr. Kaufman and Mr. Wilson recommend that only the Arkansas portion should be included. Ms. Kilburn advocates a total Company basis, consistent with the treatment of the other capital components of debt and equity.

Ms. Kilburn's usage of total company deferrals is sketched in her testimony:

> A total company perspective with regard to capitalization is necessary to accurately pinpoint SWBT's cost of capital. Given that all dollars are fungible, it is impossible to distinguish dollars supporting Arkansas rate base from those supporting Texas rate base or the other states served by SWBT. (T. 1081).
>
> . . . The cost rate associated with accumulated deferred taxes and investment tax credits is zero since these are ratepayer-supplied funds. Theoretically equivalent ways of treating these cost-free sources are

> to deduct them from rate base or to include them in the capital structure at zero cost. In this case they have been included in the capital structure at zero cost. The more appropriate treatment in this case is to include all liabilities of SWBT in arriving at its overall cost of capital. (T. 1082).
>
> Although I agree that the Company's assets can be pinpointed, I totally disagree that any specific dollars, or liabilities, supporting any specific asset can be identified with certainty. All dollars are fungible. (T. 1116).

Staff's argument is summarized very well in its brief as follows:

> Staff's position is that no specific capital source can be identified as supporting any particular asset; all dollars are fungible. Mr. Kaufman . . . to the extent that total capitalization creates a pool of funds available for total SWBT operations, it is impossible to accurately distinguish component sources of capital among jurisdictional operations. The Company made no attempt to identify particular debt or equity issues with specific assets, thus recognizing fungibility. Staff's position is consistent with the Company's approach and simply recognizes that fungibility applies to *all* funds. (T. 1153).
>
> Staff agrees that assets can be pinpointed. It is the source of funds truly supporting those assets which cannot be identified . . . The Company's only argument against Ms. Kilburn's approach was that numbers appeared in accounts. Mr. Neal's testimony did not address the appropriate ratemaking treatment of booked amounts in ADIT or ITC accounts. (T. 1160, 1175). This Commission has recognized the issue of fungibility as a financial one. Order No. 7 in Docket No. 83-136-U, Associated Natural Gas, stated "As Staff correctly points out, the question involved in this issue is a financial one. The local/accounting re-

strictions which ANG argues are applicable to the funds are irrelevant since the financial approach recognizes the real fungibility of dollars." Staff Brief at 16-17.

The Attorney General and SWB both dispute Ms. Kilburn's Capital Structure. SWB's brief goes to great length (18 pages) to explain why Ms. Kilburn's treatment is inappropriate. A partial extract of SWB's brief summarizes the central elements of the Company's position:

> Ms. Kilburn attempts to explain this theory by the illogical conclusion that all dollars are fungible and it is impossible to distinguish dollars supporting the Arkansas rate base from those supporting other jurisdictional rate bases in the remaining four Southwestern Bell Telephone states. This so-called "fungibility" argument is the total basis for her inclusion of "total company" numbers for the capital structure components of Accumulated Deferred Income Taxes and Pre-1971 Investment Tax Credits. Ms. Kilburn verified, on cross-examination, that her "total company" numbers include all intrastate and interstate amounts for all five Southwestern Bell Telephone states. (T. 1163). It was also established that no Staff witness has ever presented this type of capital structure to the Arkansas Commission prior to this docket. (T. 1122).
>
> The first erroneous premise proferred by Ms. Kilburn is the allegation that it is impossible to distinguish dollars supporting the Arkansas rate base from those supporting the other jurisdictional rate bases (i.e., Texas, Oklahoma, Missouri and Kansas). On cross-examination Ms. Kilburn was confronted with several past cases where she and Staff auditors had distinguished or segregated the dollars supporting the Arkansas rate base and the Arkansas deferred taxes.

> Ms. Kilburn was incapable of explaining how the "impossible" had been done on a consistent basis in all previous rate cases. Ms. Kilburn first responded that she meant to say "impossible to accurately distinguish." (T. 1152). SWB Brief at 13-14.

SWB quotes at some length in its brief the testimony of PCS Staff witness Mr. Travis Neal, Auditor (T. 483-485) as to the intrastate Arkansas booked amount for deferred taxes and the Staff recommended rate base, and argues:

> The preceding testimony verifies that the proposed Staff rate base includes the *Arkansas intrastate (booked) amounts* for Accumulated Deferred Income Taxes $108,574,000) and Pre-12981 Investment Tax Credits, ($580,000). The actual percentage of the Arkansas intrastate rate base attributable to Accumulated Deferred Income Taxes and Pre-1971 Unamortized Investment Tax Credits is 14.81% and not the "total company" percentage of *16.72%* utilized by Ms. Kilburn. Ms. Kilburn's own auditor verifies under oath that the intrastate booked amounts ($580,000 and $108,574,000) are the amounts included in Staff's rate base and created by Arkansas investment. Mr. Neal also agrees that these same intrastate amounts should be deducted from the rate base if the zero-cost capital is excluded from the capital structure. SWB brief at 21-22.

Staff in its initial brief and reply brief argues that Mr. Neal was merely testifying as to what account balances the Company booked into various account. Staff asserts that the determination of the capital structure is a financial and ratemaking decision, beyond the expertise of Mr. Neal and that Ms. Kilburn's determination of the proper capital structure is appropriate.

We find the Staff position, all liabilities, including cost free sources such as tax deferrals, are akin and not traceable to specific assets, appealing. We understand the argument that it is very difficult, if not impossible, to attribute particular tax credits to particular assets since dollars are fungible or identical and liabilities are not matched to particular assets. Accounting conventions may well be an estimate and not necessarily accurate.

However, we are aware of the practice of the Company in attributing ADIT's and ITC's to various state jurisdictions and of the past practice of this Commission of accepting SWB's practice of considering Arkansas-only treatment of deferred tax dollars. However, we think the evidence in this particular case is mixed on the validity of taking Arkansas-only or Company-wide cost free funds into account in determining the cost of capital. Therefore, we choose at this particular time to accept the capital structure of the Attorney General and SWB and to reject at this particular time Staff's "fungibility" argument as it applies to SWB. Although it appears that Ms. Kilburn's proposed treatment is consistent with methodology used by this Commission in the AP&L Docket No. 84-199-U case, it remains a question in the Commission's mind as to whether the multi-jurisdictional nature of SWB has any impact on the use of that methodology. The situation with SWB, with more than five times as many extra-Arkansas assets as intra-Arkansas assets in comparison to AP&L's situation is of significance to the Commission. We specifically reserve judgment to reconsider this matter on rehearing, if necessary, or in subsequent cases.

It is an established principle of law in the State of Arkansas that "no public utility has a vested right to

any particular method of valuation." 220 Ark. at 84. Moreover, there is no "judicial mandate requiring the commission to take the same approach to every rate application, or even to consecutive applications by the same utility. . . ." *Southwestern Bell Telephone Company v. Arkansas Public Service Commission*, 267 Ark. 550, 566-567 (1980). In fact, "every rate order may be superseded by another, not only when conditions change, but also when the administrative understanding of the same conditions changes." *Id.* at 567 (citing Davis, *Administrative Law Treatise* 610, § 18.09). Furthermore, agencies such as this Commission "are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances." *Id.* Therefore, "[t]he commission has a wide discretion in choosing its approach to rate regulation." *Id.* at 568.

C. *Cost of Capital*

The Capital Structure which the Commission finds to be most justified by the evidence and the resulting overall cost of capital is set out on the following page:

COST OF CAPITAL
(As of September 1984)

Component	$ Amount (000's)	Ratio	Cost	Weighted Cost
Common Equity	$ 6,610,715	.55492	.1350	.0749142
Total Debt	5,298,349	.44476	.09501	.0422566
Customer Deposits	3,828	.00032	.06000	.0000192
TOTALS	$11,912,892	100%		.11719
				X .8519*
				.0996

Cost of Capital=9.98%

*Adjustment to reflect 14.81% of Arkansas interstate rate base attributable to ADIT & ITC (100 - .1481=8519)

VII. ACCOUNTING

A. *UNCONTESTED ADJUSTMENTS*

While no formal stipulation was entered into by Staff and SWB, many of Staff's adjustments were not opposed by SWB. Therefore, we accept as reasonable the following adjustments:

1. Staff Adjustment (1)A: To increase plant in service $4,066,000 to account for the customer premises equipment (CPE) phase down.
2. Staff Adjustment (2)B: To increase the depreciation reserve by $533,000 for the CPE phase down.
3. Staff Adjustment (2)C: To increase the depreciation reserve by $2,095,000 to include depreciation expense calculated on the test year end level of plant in service.
4. Staff Adjustment (3)A: To reduce plant in service by $617,000 to remove plant under construction that will not be completed within 12 months.
5. Staff Adjustment (4)A: To increase the materials and supplies account by $181,000 to bring it to a thirteen-month average.
6. Staff Adjustment (6)A: To reduce local revenues by $15,320,000 to a test year end level.
7. Staff Adjustment (6)C: To increase local revenues by $7,977,000 for revenues anticipated under tariffs designed under order of the Eighth Circuit Court of Appeals.
8. Staff Adjustment (7)A: To increase access revenues by $8,839,000 to a test year level.
9. Staff Adjustment (7)B: To increase access revenues by $1,331,000 for revenues anticipated under tariffs designed under order of the Eighth Circuit Court of Appeals.

10. Staff Adjustment (8)A: To decrease toll revenue by $5,713,000 to a test year end level.

11. Staff Adjustment (8)B: To increase toll revenue by $2,742,000 for revenues anticipated under tariffs designed under order of the Eighth Circuit Court of Appeals.

12. Staff Adjustment (9)A: To increase miscellaneous revenues by $6,717,000 to a test year end level.

13. Staff Adjustment (9)C: To increase miscellaneous revenues by $4,564,000 to impute to Southwestern Bell Telephone Yellow Pages revenues recorded on the books f a related company.

14. Staff Adjustment (10)A: To reduce uncollectibles by $76,000 to a test year end level.

15. Staff Adjustment (11)A: To reduce maintenance expense by $1,596,000 to a test year end level.

16. Staff Adjustment (11)B: To increase maintenance expense by $2,855,000 to normalize the April 1985 and August 1985 wage and salary increases.

17. Staff Adjustment (11)C: To increase maintenance expense by $164,000 to include items amortized in previous dockets before this Commission.

18. Staff Adjustment (11)D: To increase maintenance expense by $630,000 to account for the CPE phase down.

19. Staff Adjustment (12)A: To decrease traffic expense by $1,106,000 to a test year end level.

20. Staff Adjustment (12)B: To increase traffic expense by $493,000 to normalize the April 1985 and August 1985 wage and salary increase.

21. Staff Adjustment (12)C: To increase traffic expense by $14,000 to recognize "right to use" fees ordered amortized in prior dockets.

22. Staff Adjustment (13)A: To decrease commercial expense by $1,104,000 to a test year end level.

23. Staff Adjustment (13)B: To increase commercial expense by $945,000 to normalize the April 1985 and August 1985 wage and salary increase.

24. Staff Adjustment (13)C: To decrease commercial expense by $2,000 to remove the cost of chamber of commerce and civic club dues and meals.

25. Staff Adjustment (13)E: To decrease commercial expense by $522,000 to eliminate advertising which does not directly benefit Arkansas ratepayers.

26. Staff Adjustment (13)F: To increase commercial expense by $944,000 to reflect revenues that will be lost upon expiration of the AT&T Information System, Inc. (AT&T-IS) billing contract.

27. Staff Adjustment (13)G: To increase commercial expense by $1,608,000 to impute to Southwestern Bell Telephone expenses of publishing Yellow Pages that were recorded on the books of a related company.

28. Staff Adjustment (14)A: To decrease revenue accounting expense by $694,000 to a test year end level.

29. Staff Adjustment (14)B: To increase revenue accounting expense by $206,000 to normalize the April 1985 and August 1985 wage and salary increase.

30. Staff Adjustment (14)C: To increase revenue accounting expense by $715,000 to reflect revenues that will be lost upon the expiration of the AT&T-IS billing contract.

31. Staff Adjustment (14)E: To increase revenue accounting expense by $111,000 to normalize the February 1985 postal rate increase.

32. Staff Adjustment (15)A: To increase operating rents by $1,619,000 to a test year end level.

33. Staff Adjustment (16)A: To decrease general services and licenses expense by $2,820,000 to a test year end level.

34. Staff Adjustment (17)A: To increase relief and pension expense by $1,156,000 to a test year end level.

35. Staff Adjustment (17)B: To increase relief and pension expense by $388,000 to normalize the April 1985 and August 1985 wage and salary increases.

36. Staff Adjustment (17)C: To increase relief and pension expense by $2,000 to account for items ordered amortized in prior dockets.

37. Staff Adjustment (17)D: To increase relief and pension expense by $264,000 to reflect the loss of revenue upon termination of the AT&T-IS billing contract.

38. Staff Adjustment (17)E: To decrease relief and pension expense by $124,000 to remove lobbying expense.

39. Staff Adjustment (18)A: To increase other general expenses by $1,288,000 to a test year end level.

40. Staff Adjustment (18)B: To increase other general expenses by $815,000 to normalize the April 1985 and August 1985 salary and wage increases.

41. Staff Adjustment (18)C: To increase other general expense by $5,000 to account for items ordered amortized in prior dockets.

42. Staff Adjustment (18)D: To increase other general expense by $35,000 to account for the CPE phase down.

43. Staff Adjustment (18)E: To decrease other general expense by $242,000 to eliminate airplane expense.

44. Staff Adjustment (18)F: To decrease other general expense by $615,000 to eliminate a portion of public relations expense.

45. Staff Adjustment (18)G: To decrease other general expense by $13,000 to eliminate employees' private use of company vehicles.

46. Staff Adjustment (18)H: To decrease other general expense by $7,000 to eliminate the cost of chamber of commerce and civic club dues and membership.

47. Staff Adjustment (18)I: To decrease other general expense by $45,000 to eliminate the cost of the "Telephone Times" employee publication.

48. Staff Adjustment (18)J: To decrease other general expense by $113,000 to remove Pioneer expense.

49. Staff Adjustment (18)K: To increase other general expense by $227,000 to reflect the loss of revenue upon termination of the AT&T-IS billing contract.

50. Staff Adjustment (18)L: To decrease other general expense by $11,000 to eliminate communications expense allocated to Arkansas for Bell Communications Research, Inc. (Bellcore).

51. Staff Adjustment (18)M: To decrease other general expense by $6,000 to eliminate federal regulatory expense allocated to Arkansas for Bellcore.

52. Staff Adjustment (18)N: To decrease other general expense by $22,000 to eliminate governmental affairs expense allocated to Arkansas for Bellcore.

53. Staff Adjustment (18)O: To reduce other general expense by $5,000 to remove lobbying expense.

54. Staff Adjustment (18)Q: To increase other general expense by $8,000 to normalize the February 1985 postage increase.

55. Staff Adjustment (19)A: To increase depreciation expense by $5,996,000 to a test year end level.

56. Staff Adjustment (19)C: To increase depreciation expense by $653,000 to provide for the CPE phase down.

57. Staff Adjustment (20)A: To decrease taxes other than income by $408,000 to a test year end level.

58. Staff Adjustment (20)B: To increase taxes other than income by $254,000 to normalize the April 1985 and August 1985 salary and wage increases.

59. Staff Adjustment (20)C: To reduce taxes other than income by $4,000 to remove Pioneer expense.

60. Staff Adjustment (20)D: To increase taxes other than income by $37,000 to reflect the CPE phase down.

61. Staff Adjustment (20)E: To increase taxes other than income by $104,000 to account for the FICA tax base and increase during the *pro forma* year.

B. *CONTESTED ISSUES*

1. *WAGES AND SALARIES*

On January 11, 1985, SWB filed a Motion for Protective Order pursuant to Ark. Stat. Ann. § 73-226 requesting therein that all testimony and exhibits relating to the wage and salary issue be declared proprietary by the Commission. On March 5, 1985, the Commission, sitting *in*

camera, heard arguments on SWB's Motion from all interested parties. Said Motion was supported by all other parties to the wage and salary issue.

Protection for proprietary and trade secret information is provided for by Ark. Stat. Ann. § 73-226 which was added to the regulatory statutes of Arkansas by Act 913 of 1981. A protective order is available and appropriate whenever the Commission determines it to be necessary in the interest of a utility to protect trade secrets or proprietary information. Upon making such a determination, the Commission can take all necessary action to prevent the unnecessary disclosure of such information.

After reviewing the information relating to wages and salaries, the Commission determined that SWB's arguments concerning the proprietary nature of the material were, in fact, valid. The testimony and exhibits on this issue contain wage and salary, tenure, and other personnel types of data comparisons. The compilation of this information involved a substantial expenditure of time, effort and expense on the part of SWB, Staff and outside consultants. Release of this information to the general public could perhaps enable the competitors of SWB to assess salaries and wages of SWB employees and use that assessment to assist the competitor's in offering jobs to and hiring SWB employees. In today's partially competitive environment in the telecommunications industry, this threat is a real possibility and efforts must be made to limit access to the sensitive and confidential information.

The Commission also determined that the Staff and the Attorney General could in fact adequately protect the

interest of the ratepayers of Arkansas if this particular information was protected from release. Further, the Commission determined that the attorneys representing the Intervenors who are potential "competitors" of SWB for the Company's employees could adequately protect the interest of their clients even if the information was protected from disclosure. Finally, the Commission determined that it would be less of an administrative burden and far more efficient to hold the proceedings involving wages and salaries on an *in camera* basis. By doing so, the parties were allowed a full opportunity to cross-examine the witnesses, and the witnesses were able to make their responses to questions without the worry of accidentally disclosing proprietary information in an open public hearing. In summary, the Commission determined that the interest of SWB, Staff, Intervenors and the citizens of Arkansas would best be served by dealing with the wage and salary issue in an *in camera* proceeding. Accordingly, by Order No. 19 entered herein on March 19, 1985, the Commission granted the Company's Motion for Protective Order and directed that all proceedings involving the wage and salary phase of this rate case be held *in camera* and that the entire record on this issue be sealed. The Commission further ordered SWB to review the record under seal in two years to determine if the protected information could be released to the general public at that time.

In accordance with Order No. 19, further hearings on the wage and salary issue were held, *in camera* on March 6 and 25, 1985. Staff argued that SWB's *pro forma* year wage and salary expenses should be adjusted downward by approximately $6,916,000, based upon the evidence of-

fered by Staff's consultant and Staff Witness Mr. James B. Miles. The Company argued that the Commission was pre-empted from making such an adjustment by the National Labor Relations Act, and further, not withstanding the pre-emption issue, that Staff's proposed adjustment was unreasonable and not supported by the record.

SWB employs approximately 70,000 employees in the five states of Arkansas, Kansas, Missouri, Oklahoma and Texas. Of those employees, approximately 50,000 are nonmanagement bargaining unit employees represented by the Communications Workers of America (CWA), a national union. (T. 1455). These employees are paid wages which have been negotiated between the Company and the CWA. (T. 1454). The remaining 20,000 employees are management employees who are paid salaries pursuant to a formal, professionally developed management salary plan administered by the Company. (T. 1518-1519). SWB employs approximately 3,000 nonmanagement employees and 1,250 management employees in Arkansas. (T. 1456).

On January 1, 1984, SWB became a wholly owned subsidiary of Southwestern Bell Corporation, separate and apart from AT&T. The Company's 1983 union contract expires August 9, 1986. At that time, SWB will bargain for the first time as a separate company with the CWA over the wages and working conditions of the nonmanagement bargaining unit employees.

SWB began changing its management salary plan at divestiture and has already implemented several changes from the management salary plan the Company administered while part of the Bell System. (T. 1302-1303, 1521-1522).

Approximately 30% of SWB's wages and salaries are allocated through the separations process to the interstate jurisdiction. (T. 1325-1326). The remaining 70% is allocated to the intrastate jurisdiction for ratemaking purposes. (T. 1346).

The Staff addressed the issue of the Company's wages and salaries in Docket No. 82-037-U, however, no specific adjustment was made by Staff in that proceeding. Although Staff recommended in Docket No. 82-057-U that the issue be addressed in the future, due to the unprecedented nature of divesture Staff did not address the wage and salary adjustment in SWB's next rate case, Docket No. 83-045-U. Staff asserts they addressed the issue in this proceeding because it is SWB's first post-divestiture rate application and the Company is no longer a division of AT&T subject to the compensation plan established by AT&T.

Mr. Miles recommended that the *pro forma* year wage and salary expenses be adjusted downwards by $6,916,000. (T. 1251). At pages 43 and 44 of SWB's Initial Brief the Company states that Mr. Miles, in calculating his adjustment, failed to reduce the *pro forma* year expense by the amount of expense disallowances recommended by Staff witness Merritt. Staff, at page 3 of its Brief on the wage and salary issue, agreed with the Company on this matter. Mr. Miles' adjustment was therefore recalculated to be $6,877,000.

Mr. Miles further recommended that the Commission should reassess SWB's pay levels in the future and make a further downward adjustment if warranted. Mr. Miles urges the five state utility Commissions that regulate the

Company join together and establish a base year for comparison purposes to ensure consistent regulatory treatment of SWB's compensation expenses. (T. 1252).

The Company claimed that the National Labor Relations Act, 29 U.S.C. § 141, *et seq.*, preempted the Commission's jurisdiction to accept an adjustment such as the one recommended by Staff in this case. SWB cited a number of cases which it claims support this point, however, it admits that there is no case directly on point with regard to a public utility commission's authority relating to wages established through collective bargaining. A careful review of the authorities cited by the Company reveals that this Commission is not preempted in considering the adjustment proposed by Staff. In *Amalgamated Transit Union, Division 819 v. Byrne,* 568 F.2d 1025 (3d Cir. 1977), the U. S. Court of Appeals stated that "there is a presumption that state authority has not been ousted by Congressional action." *Id.* at 1028. The Court emphasized that the "touchstone" of preemption is the "Congressional intent to preempt." *Id.*

In that case the Governor and Transportation Commissioner of New Jersey threatened to withdraw state subsidies of private transportation companies that agree to include the unlimited cost of living increases in their collective bargaining agreements. The Court stated that it did not believe that ". . . New Jersey's action here constitutes the governmental attempt to dictate the substance of collective bargaining agreements. . ." *Id.* at 1029. The Court stated:

> "Thus, New Jersey's interest in the collective bargaining agreements is similar to that of any private

> purchaser of services which expresses an interest in the terms of a collective bargaining agreement under consideration by the provider of the services. New Jersey, like the private consumer, is attempting to exert pressure on the parties to the collective bargaining negotiations in order to hold down the costs of purchasing the 'essential' transportation services these companies provide." Id.

The Court emphasized that Congress had explicitly exempted New Jersey from the proscriptions of the National Labor Relations Act in that New Jersey was not an "employer", "labor organization" or "agent" of a labor organization.

In conclusion, the Court stated that "New Jersey has asserted an interest in having transportation services provided to the public rather than a broad interest in labor relations per se. . ." *Id.* at 1030. Further, ". . . New Jersey's interest is that of insuring that 'essential' transportation services are provided to the public, rather than regulating labor relations per se." *Id.*

Here, in considering Staff's proposed adjustment, the Commission is merely attempting to set reasonable rates for a public utility, and not attempting to regulate labor relations per se. Therefore, according to this case, the Public Service Commission is not preempted by the National Labor Relations Act from reviewing the appropriateness of the wage levels of a jurisdictional utility.

In *Sears, Roebuck & Co. v. Carpenters,* 436 U.S. 180, 56 L. Ed. 2d 209 (1978), the United States Supreme Court held that the National Labor Relations Act does not deprive a state court of the power to consider an action by

an employer to enforce state trespass laws against peaceful picketing. In so ruling, the Supreme Court stated:

> " . . . the history of the labor pre-emption doctrine in this Court does not support an approach which sweeps away state-court jurisdiction over conduct traditionally subject to state regulation without careful consideration of the relative impact of such a jurisdictional bar on the various interests affected.
>
> . . . [I]nflexible application of the doctrine is to be avoided, especially where the State has a substantial interest in regulation of the conduct at issue and the State's interest is one that does not threaten undue interference with the federal regulatory scheme." (Citing *Farmer v. Carpenters,* 430 U.S. 290). 56 L. Ed. 2d 209 at 219-20.

If, as the Company contends, the National Labor Relations Act preempts this Commission from adopting the adjustment proposed by Staff in this case, it would indeed sweep away state "jurisdiction over conduct traditionally subject to state regulation". Moreover, the State "has a substantial interest in regulation of the conduct at issue", namely, the setting of utility rates within the State.

> The Supreme Court continued by stating:
>
> "The critical inquiry, therefore, is not whether the State is enforcing a law relating specifically to labor relations or one of general application but whether the controversy presented to the state court is identical to . . . or different from . . . that which could have been, but was not, presented to the Labor Board. For it is *only* in the former situation that a state court's exercise of jurisdiction necessarily involves a risk of interference with the unfair labor practice jurisdiction of the Board . . ." (Emphasis supplied) Id. at 225-26.

The issue of whether the wage and salary expense of SWB is reasonable from a ratemaking perspective is, with-

out a doubt, *not* an issue identical to one which could have been presented to the National Labor Relations Board.

In *Lodge 76, International Association of Machinists and Aerospace Workers, AFL-CIO, et al. v. Wisconsin Employment Relations Commission, et al.*, 427 U.S. 132, 49 L. Ed.2d 396 (1976), the Supreme Court stated that ". . . the federal law governing labor relations does not withdraw 'from the States . . . power to regulate where the activity regulated [is] a merely peripheral concern of the Labor Management Relations Act' ". 49 L. Ed.2d 396 at 401. The determination of reasonable rates for a public utility is not even a peripheral concern of the Labor Management Relations Act. Ratemaking is even further removed.

Based on the above cited authority, SWB's argument that the Commission's authority to accept Staff's wage and salary adjustment is preempted by the National Labor Relation Act must fail. Mr. Miles' downward adjustment to the Company's *pro forma* year salary expense was based upon a survey conducted by Mr. Thomas M. Riley, a consulting principal employed by A. S. Hansen, Inc. The Hansen consultants reviewed a list of job titles and job descriptions provided by the Company. From a list of approximately one hundred and twelve (112) positions in Arkansas, Hansen selected twenty-four (24) positions that represented positions that might have counterparts or comparable matches in other companies in Arkansas and for which compensation data would be available. (T. 1361). In gathering competitive data on the twenty-four (24) positions selected, the Hansen consultants utilized SWB's job descriptions as a guide, as well as the Com-

pany's organizational structure to determine levels of positions within the organization. Hansen concluded that SWB's pay level for the positions surveyed are above the level of the competitive market in Arkansas, using as reference point a range from ninety percent (90%) to one hundred and ten percent (110%) of the average competitive salary for a job. Mr. Miles' adjustment is based upon the underlying assumption that the twenty-four (24) positions selected by Hansen are representative of all the SWB positions in Arkansas.

The Company contends that the twenty-four (24) positions used in Staff's testimony were arbitrarily selected and, therefore, are an unrepresentative sample which distorts any findings applied to the entire SWB work force. However, the assessment of market comparability submitted by the Company in rebuttal to Staff's position appears to support Staff's contention that wages and salaries paid by SWB are above the competitive average. (Barnes Ex. No. 1 and Barnes Supplemental Ex. No. 1).

While we agree with Staff's conclusion that the salaries for the twenty-four (24) positions surveyed are above the competitive level in Arkansas, we agree with SWB that such a sample may not be representative of the Company's entire work force. Therefore, with certain exceptions discussed below, we accept Staff's adjustment to wages and salaries as it applies to the 24 positions surveyed, but we do not find substantial evidence in the record to support an adjustment for the entire SWB work force.

Staff witness Riley testified that the definition of competitive market depends upon the job in question. (T. 1393). To determine the competitive market, one has to

look to the market within which a company recruits, where the people normally come from and the salary level which is competitive in that particular market. We conceded that eight (8) of the twenty-four (24) positions surveyed were within the national competitive market. (Riley-SWBT Cross-Examination Exhibit 1). Mr. Riley, however, did not use the national job market when comparing the subject eight (8) positions. We, therefore, are uncertain of the validity of Staff's comparisons on those eight (8) positions which have a nationwide competitive market and we find that the data on those eight (8) positions should be removed from Staff's proposed adjustment.

SWB asserts that the Hansen study reaches conclusions based upon incomplete evaluations distorting the truth and utilizes data for regional competitive markets which encompasses only three (3) of the five (5) states in which SWB operates. Further, it contends that Hansen did not actually evaluate the Company's positions for job content and responsibility nor did the survey compare SWB positions with comparable positions. Staff states that the Hansen study utilized a methodology which is standard within the compensation field and the job description comparisons are valid and complete.

After review of the testimony and exhibits on this issue, we find substantial evidence in the record supports the Hansen analysis as valid and complete. As to any alleged failure to exactly match job content and responsibility argued by SWB, the Commission is of the opinion that the Company's standard of comparison is too rigid. No two positions in two different companies will be exactly comparable in content and responsibility. However,

the fact that they are not absolutely identical does not render comparisons meaningless. Staff has compared data from a majority of the states where the Company operates to compare regional competitive markets. The Staff, through consultants, has attempted to make the best comparisons possible of positions within SWB and other companies and they have succeeded to the degree required for this Commission to accept a wage and salary adjustment for the positions analyzed.

Based upon the foregoing findings that the Hansen study is valid and that Staff's recommended wage and salary adjustment is valid, in part, we find that SWB's *pro forma* year salary expense should be adjusted downward. Our adjustment is derived from the following specific findings relating to this issue:

1. That ratepayers should only be charged with that portion of wages and salaries that is within a reasonable range of the competitive market;

2. That a reasonable range for rates of pay to be competitive is from ninety percent (90%) to one hundred and ten percent (110%) of the average competitive salary for that job (T. 1362); and,

3. That the competitive market varies with the job, making some jobs competitive in the statewide or regional market, while others are competitive in the national market. (T. 1393).

Our adjustment to SWB wage and salary expense is derived by taking the twenty-four (24) job titles used in the Hansen survey, eliminating those eight (8) jobs that have nationwide competitive markets (Riley-SWBT Cross

Ex. No. 1), multiplying the number of incumbents in each position times the SWB average salary for each position, and multiplying that product times the excess over 110% of the Hansen average for each position. The calculation of this adjustment is more fully set forth in Appendix B to this Order. Appendix B contains information which is proprietary pursuant to Order No. 19 entered March 19, 1985, in this Docket. Therefore, Appendix B is proprietary under the terms of Order No. 19 and shall be maintained under seal.

The calculation set forth above results in a downward adjustment of SWB's wage and salary expense of $4,627,900, which after adjustment for benefits and taxes results in a downward adjustment of $5,155,000 in SWB's *pro forma* year wage and salary expense.

2. *WAGE AND SALARY DOUBLE-COUNT*

We must consider the impact of an adjustment to SWB's wage and salary expense on other adjustments proposed by Staff.

Staff witness Rodney Merritt proposed three adjustments which in part also disallowed wage or salary expenses. The adjustments were: (1) Pioneer expense. (T. 507-508); (2) lobbying expense (T. 508); and (3) public relations expense (T. 507). These three adjustments disallowed a total of $487,000 of wage and salary expense. (Lampkin Exhibit R-5).

Staff, in computing its recommended disallowance of wage and salary expense, used the full *pro forma* year wage and salary expense. (T. 1253-1254) (Staff Exhibit JBM-2). Mr. Miles did not reduce the *pro forma* year

expense by the amount of the expense disallowances recommended by Mr. Merritt. (T. 528-529). To be fair and consistent, Mr. Miles should have removed Mr. Merritt's disallowances.

When Mr. Miles' proposed adjustment is recalculated to account for Mr. Merritt's disallowances, the *pro forma* wage and salary expense drops from $68,145,000 to 87,-658,000. Mr. Miles' total adjustment as a result would then drops from $6,915,000 to $6,877,000, a decrease of $38,000. (Lampkin Exhibit R-5 T. 350).

We must recognize the double-counting which results from disregarding Mr. Merritt's adjustments. To fail to account for Mr. Merritt's adjustment would, as acknowledged by Mr. Merritt, result in an overstatement of Mr. Miles' adjustments (T. 529), and would be arbitrary and capricious. Accordingly, we have taken Mr. Merritt's adjustment into account in our calculation of our wage and salary adjustment described hereinabove.

3. *MATERIALS AND SUPPLIES*

Staff proposed a disallowance of a portion of SWB's investment in materials and supplies by reducing the investment by the average percent of accounts payable on the materials and supplies balance.

Staff's adjustment eliminates that portion of SWB's materials and supplies which has been financed by accounts payable. The purpose of the adjustment is to prohibit SWB from earning a return on vendor-supplied funds. The record reflects that 20.3 percent of the average material and supplies balance claimed in the rate base is financed by accounts payable. The Company has such

material and supply related accounts payable on a continuing basis throughout the year. To allow the Company to maintain this portion of its material and supplies in its rate base for rate making purposes, is to allow the Company to earn a return on funds supplied by the material and supply vendors. The stockholders of the Company have not, with regard to this adjustment, supplied the funds upon which the Company is seeking to earn a return. It is the policy of this Commission to prohibit the Company from earning a return on non-investor supplied capital.

This adjustment, using the same methodology, was previously made in Docket No. 83-045-U and was approved then by this Commission. The Company made no objections to the adjustment to materials and supplies in Docket No. 83-045-U.

SWB now argues that Staff's adjustment conflicts with the Commission's *Rules of Practice and Procedure.* Specifically, SWB contends that Rule 9, Schedule E-6 of the *Rules of Practice and Procedure* requires that the materials and supplies inventory adjustment be set at an average amount per books level. (T. 342). A complete reading of Rule 9, Schedule E-6 reveals that "Materials and Supplies inventory shall be *based on* actual amounts per books on an average basis for the test year." (Emphasis added). Staff's adjustment is in compliance with this rule. The materials and supplies adjustment is in fact based on actual amounts per books.

The Commission agrees with Staff's position that the adjustment is proper and does not cause improper mixing of methods of accounting.

The materials and supplies adjustment is consistent with Commission precedent and policy prohibiting a return on non-investor supplied capital. The Commission, therefore, accepts Staff's adjustment which decreases Materials and Supplies by $1,220,000.

4. *CASH WORKING CAPITAL*

SWB initially requested approval of a cash working capital requirement (CWCR) in the amount of $5,548,000, however, this request was later reduced to $1,823,000. (Lampkin Exhibit R-3). Staff supports a negative CWCR for SWB of ($4,297,000). (Merritt Revised Exhibit RM-2).

The methodology employed by Staff to derive its ($4,297,000) CWCR appears to be the same methodology as used by SWB with a few notable exceptions. (T. 472). Staff included accrued interest suspense in its CWCR calculation. The net revenue lags for all of the various expenses and tax components are those which were used by SWB, with the exception of the "net of revenue and expense lag" for federal income taxes and the "net of revenue and expense lag" for interest expense. While SWB used a net expense lag of 62.88 days for federal income taxes, Staff used the appropriate net expense lag of 34.35 days. The calculation of this net federal income tax expense lag is shown in Schedule TN-1. The weighted federal income tax payment lag of 59.5 days shown in Schedule TN-1 is based on the accelerated corporate income tax payment schedule as required by the Tax Equity and Fiscal Responsibility Act of 1982. Furthermore, this is the same net expense lag as was used in SWB's last rate case, Docket No. 83-045-U.

Staff's adjustment to include accrued interest expense recognizes that SWB collects interest from the ratepayers as revenues are collected and has the use of that ratepayer money until the interest payments are remitted semiannually. (T. 498). This adjustment recognizes that accrued interest is a source of working capital to SWB, and, therefore, reduces the amount of CWCR required to be funded by the investors. This adjustment takes into consideration non-investor supplied capital and is fully supported by the Commission.

SWB offered little testimony in support of its CWCR calculation. SWB's witness indicated that SWB's CWCR calculations employed the same procedure as followed by the Commission for the last several rate cases. (T. 343). No further support is given for SWB's CWCR calculation except for SWB's statement that, "we do not agree on adjustment No. 6, Cash Working Capital." (T. 349). SWB's cross-examination of Staff's witnesses on this issue failed to discount Staff's methodology.

Staff takes the position that CWCR represents a utility's day-to-day cash outlays, and such items as depreciation, deferred taxes, interest, and dividends are properly excluded in determining CWCR. We agree. Based upon this definition of CWCR, Staff correctly took into consideration accrued interest expenses in its CWCR calculation. As stated previously, SWB has use of these ratepayer funds from the time they are collected from the ratepayers until the time they are actually used to pay the interest expense. Therefore, these funds are ratepayer supplied and are properly used to offset the Company's CWCR. Staff has clearly followed Commission precedent,

which was succinctly stated in Order No. 17 in Docket No. 81-144-U as follows :

> "In actual fact, the working capital allowance should probably only be allowed to the extent that the utility can demonstrate that in fact the funds were required to operate the utility, and are supplied by the investors themselves . . . . It is obvious that this Company and all other companies use the money paid them by the ratepayers to pay these bills, and the time has come to stop this practice unless it could be clearly shown that the investor's funds are in fact involved, and then only to that extent. It is worthy of note here that the FERC is rethinking its position on this matter. We serve notice on this utility and all others that no longer is there a presumption that working capital allowance is automatically deemed to be investor-supplied capital. In point of fact, the presumption will be that monies used to pay bills, the basis on which the working capital allowance is based, are ratepayer funds unless shown otherwise by the company."

The Commission precedent in Docket No. 81-144-U was also recently followed in the *Rate Application of General Telephone of the Southwest.* Order No. 13, Docket No. 83-147-U.

The record in the present case clearly supports the continued application of the Commission's policy with regard to the calculation of CWCR. We find that Staff's CWCR calculation methodology is reasonable and supported by substantial evidence as well as Commission precedent, therefore, said methodology is hereby accepted. However, Staff's negative CWCR calculation of ($4,297,000) must be recomputed. This recomputation is made necessary as a result of our decision not to accept Staff's pro-

posed capital structure and resulting proposed weighted cost of debt. We have instead accepted the proposed capital structure of SWB and the Attorney General. The resulting change in the weighted cost of debt necessitates the recalculation of Staff's CWCR figure. Flowing this change through the CWCR calculation changes Staff's negative CWCR figure of ($4,297,000) to a negative CWCR figure of ($5,146,000). Therefore, for purposes of this rate case we adopt as reasonable a negative CWCR figure of ($5,146,000).

In the case of *AP&L v. APSC,* 261 Ark. 184, 546 S.W. 2d 720 (1977), AP&L alleged that the Commission erred in deducting a negative working capital figure from AP&L's rate base. The Arkansas Supreme Court stated, "[W]e cannot state that the Commission's decision with regard to the working capital allowance and non-investor supplied capital was either arbitrary or capricious, and we find that the Commission's handling of that matter was supported by substantial evidence and that the action of the commission in that regard should be affirmed."

5. *TAXES*

SWB and Staff agree on the methodology to be used in calculating State and Federal income taxes. The discrepancy between the parties positions on the amount of tax liability is caused by differences in operating revenues and operating expenses. Using the methodology presented by staff witness Merritt, we have calculated SWB's tax liability based on the proper levels of operating revenues and operating expenses as determined herein.

6. *TOLL AERIAL WIRE*

The Toll Aerial Wire Account is a unique account in that, unlike all other accounts, new additions have not been made to the account and, in fact, the toll wire has been fully retired. This capital investment, however, is not fully depreciated. There remains on SWB's books a substantial depreciation reserve debit balance. Staff accountant Travis Neal recommended in his testimony that the Toll Aerial Wire debit depreciation reserve amount (account 243-171) be removed from the rate base and placed in account 138, and further, that the balance in that account be amortized through account 609 (extraordinary retirement) rather than account 608 (depreciation expense). (T. 470, 476).

In his rebuttal testimony, Mr. Gerald Fuller interprets the Federal Communication Communication's (FCC) order 83-587 released December 20, 1983 to approve SWB's proposal for treatment of the Toll Aerial Wire account. SWB proposes to recover the Toll Aerial Wire account depreciation reserve deficiency by use of account 608.

Staff's proposed treatment of the account is in full accord with this Commission's decision in Docket No. 83-045-U. In accepting Staff's position in Docket No. 83-045-U, we said that Staff's proposal "has the effect of writing-off the reserve balance and not allowing SWB to continue to earn a return on the TAW which is clearly no longer used and useful." The Order further states that "such treatment is consistent with our long standing policy that an investment must be used and useful in order to earn or continue to earn a return on such investment." *Re*

Southwestern Bell Telephone Company, Docket No. 83-045-U, Order No. 29, at 22.

The Commission is not persuaded that we should change our treatment of the Toll Aerial Wire account, nor do we find that there is substantial evidence that this Commission's jurisdiction to determine interstate rate base is preempted by the FCC. As in Docket No. 83-045-U, we agree with and adopt Staff's proposal removing the Toll Aerial Wire debit depreciation reserve amount from rate base and amortizing the balance in that account through account 609 (extraordinary retirement). Accepting Staff's proposal is consistent with our treatment of this account in Docket No. 83-045-U and with our policy that an investment must be used and useful in order to earn or continue to earn a return on investment.

7. *CONCESSION SERVICE*

Concession service is telephone service provided to SWB's employees at reduced rates. Such service is authorized by Section 10 of the General Exchange Tariff. Staff witness Mr. Merritt proposed that we impute to SWB the revenue foregone by it in allowing concession service.

SWB witness Mr. David L. Metz testified that originally, concession service was provided to ensure that employees could be reached in emergencies. (T. 377). While this remains a part of the reason concession service is supplied, Mr. Metz testified concession services serve other purposes such as encouraging employees to use vertical services. (T. 378). SWB contends this stimulates the promotion of those services among friends and neighbors and thereby increases the contribution received from vertical services. Further, he contends that concession service

has also become a part of the total compensation/benefit plan for SWB's employees and retired employees. (T. 377). It alleges concession service helps SWB attract and retain the top quality, highly trained and experienced employees it needs to provide the reliable service expected by this Commission and the Arkansas ratepayers.

Mr. Merritt offered three justifications for Staff's proposed disallowance of all concession service. First, Mr. Merritt argued that concession service "send(s) employees the wrong price signals" and that because the employees receive free service they will not "appreciate the cost of providing that service." (T. 500). SWB asserts that it is the employees receiving the concession service who perform the work necessary to provide the service and, whether or not they pay for the service they receive, they know what it took to provide the service. This assumption by SWB is not necessarily true. The fact that an individual employee may install a line or run a computer is not an indication that the employee understands or knows the overall cost of providing a service. Knowledge of the labor involved in one area of producing a service does not necessarily lead to an accurate assessment of the overall cost of service.

Second, Mr. Merritt asserts that concession service should be disallowed since it is preferential treatment of a certain group of subscribers. SWB responded to this by stating that its tariffs are replete with examples of "preferential treatment" of certain classes of subscribers. Concession service discriminates against other ratepayers of the same class who are required to pay the full price for the same service. The examples cited by SWB are not strictly analogous to concession service.

Third, Staff testified that disallowance of the concessions does not require SWB to stop providing the service. SWB asserts that the disallowance of concession service indicates that the practice is unreasonable and, therefore, is a signal the service should be stopped. However, this contention runs contrary to the past practice of SWB since this Commission has disallowed concession services in previous rate cases and company management has not chosen to view this as a signal the practice should be stopped. Whether or not management elects to provide this service, is a management decision on which this Commission expresses no position.

Mr. Metz argues that concession service is a part of the labor agreement between SWB and its employees and that if the service is stopped SWB will have to negotiate with the labor union for some benefit to replace the service. SWB states that concession service, although not required by the collective bargaining agreement, is a binding course of dealing between the company and its employees through "custom and practice." Based upon this premise, SWB presented testimony on the potential consequences of discontinuing the service including possible unfair labor practice charges and the potential need to increase wages to compensate for the loss of concession services.

SWB's testimony on this issue is primarily composed of speculation regarding what would happen *if* the Commission disallowed the concession service and *if,* thereafter, SWB decided to eliminate the service. The speculative nature of this testimony is evidenced by Mr. Metz's answer in the following exchange:

Q. Are you saying that should the Commission adopt Mr. Merritt's adjustment eliminating the concession service that Southwestern Bell would discontinue such services?

A. Well, that's a decision that management would make, sir. I can't make that decision. It's a possibility. (T. 388).

As SWB's own witness admits, much of its testimony on this issue is based upon a hypothetical situation which may or may not occur, within the discretion of management, if the Commission accepts the Staff's proposal.

This Commission will not be swayed from our long standing policy by such tenuous evidence of possible harm and thinly veiled threats of management actions which SWB asserts may increase costs to ratepayers. The management of SWB, in its discretion, has chosen to forgo revenues to which it is lawfully entitled, therefore, the cost should be borne by the stockholders and not the ratepayers. We have not been presented substantial evidence which changes our policy of eliminating concession service and, consequently, we accept Staff's adjustment.

8. *PRO FORMA YELLOW PAGE ADJUSTMENTS*

Staff witness Merritt made adjustments to impute to SWB the revenues and expenses associated with Yellow Page operations of a related company for both the test year and the *pro forma* year. SWB did not dispute in this case the imputation of the test year expenses and revenues. It did, however, contend that the inclusion of the *pro forma* year revenue and expense increases was improper.

Mr. Merritt's prepared testimony explains SWB's policies of directory publication and the SWB interrogatory response on which Mr. Merritt based his *pro forma* adjustments as follows:

> "The Company has in excess of 40 directories that it issues each year within its service territory. These directory issues are published through out the year, in a scattered fashion. For example, the Company's Little Rock directory was published in February, 1984 and will be published again in February, 1985, while the Pine Bluff directory was published in April, 1984 and will be published again in April, 1985. When a directory is being published each year it is generally subject to a price increase. These price increases are effective with the date of publication of the directory and, therefore, the Company will experience advertising revenue increases throughout 1985 for all the various directories that are being published during 1985. In response to Staff's request, the Company confirmed in interrogatories Nos. 168 and 187 that, with regard to directory advertising, revenues will increase $1,594,350 and publications expenses will increase $688,000." (T. 501)

Mr. Merritt testified that the Company will be experiencing known and measurable increases in directory revenues and expenses during the *pro forma* year, and that those increases should be considered in this rate cases.

SWB objected to Mr. Merritt's *pro forma* adjustments by contending that the *pro forma* year Yellow Page adjustments were not "reasonably known and measurable" as defined by Ark. Stat. Ann. § 73-217.5 (Cum. Supp. 1983). SWB objected to the two *pro forma* year Yellow Page adjustments i.e., (9)B and (13)D by contending that the additional revenues and expenses would depend on the

level of advertising purchased by Yellow Page customers as well as other factors including customer's perceptions of the effectiveness of Yellow Page advertising, the price of alternative advertising, the growth of competing Yellow Page firms, the general state of the economy, interest rates, and tax changes affecting disposable income.

Ark. Stat. Ann. § 73-217.5 provides in part "that the Commission shall also permit adjustments to any test year so utilized to reflect the effects on an annualized basis of any and all changes in circumstances which may occur within 12 months after the end of such test year where such changes are both reasonably known and measurable."

SWB's arguments that these *pro forma* changes are not "reasonably known and measurable" appear to be at least circuitous and at most delve into the often used trial attorneys tactic of reductio ad absurdum, i.e., SWB appears to argue that this *pro forma* adjustment is not appropriate, since it is an adjustment which is based on a projection made by SWB and, therefore, since it is a projection, the actual result may depend on variables beyond the control of SWB.

When questioned by Mr. Brewer on cross-examination whether the Company's projected 10% increase in operating expenses would necessarily be based on certain assumptions made regarding the *pro forma* year, Mr. Merritt explained that in essence there is always the possibility in any *pro forma* adjustment, that actual results from the *pro forma* year may not exactly match the projection. (T. 525). This Commission finds that Mr. Merritt's *pro forma* year Yellow Page adjustments, based on figures supplied by SWB with regard to directory advertis-

ing, are reasonably known and measurable and, therefore, accepts his revenue increase of $1,594,350 and his *pro forma* publication expense figure of $688,000.

VIII. *RATE BASE CALCULATION*

Pursuant to the specific findings and conclusions contained hereinabove we find that Staff's intrastate rate base calculation (Merritt Revised RM-2), as adjusted by our findings hereinabove, is in fact supported by substantial evidence of record and is, therefore, reasonable. Accordingly we adopt the following intrastate rate base calculation for purposes of this rate case:

INTRASTATE RATE BASE

(000's Omitted)

Gross Utility Plant-in-Service	$854,464
Less: Depreciation	(139,331)
Net Utility Plant-in-Service	715,133
Plant Under Construction Completion w/i 12 months	16,378
Materials and Supplies	5,501
Working Capital	(5,146)
Total Original Cost Rate Base	$731,866

IX. *INCOME STATEMENT*

Applying the specific findings and conclusions reached herein and further adopting as reasonable all Staff adjustments not specifically addressed herein, the following calculation of SWB's Income Statement is deemed to be reasonable and adopted for purposes of this rate case.

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INCOME STATEMENT

DESCRIPTION	ADJUSTED AMOUNTS (000's Omitted)
Operating Revenues	$
Local Service	167,979
Access Charges	29,080
Toll Service	86,059
Miscellaneous	50,814
Uncollectibles	(1,746)
Total Operating Revenues	332,186
Operating Expenses and Taxes	
Maintenance	68,713
Traffic	13,385
Commercial	29,401
Revenue Accounting	3,744
Operating Rents	8,916
General Services and Licenses	0
Relief and Pensions	19,109
Other General Expense	22,265
Total Operations and Maintenance	165,533
Depreciation & Amortization	62,213
Taxes Other Than Income	18,009
Total Operating Expenses Before Income Taxes	245,755
Income Taxes—Arkansas	3,357
Income Taxes—Federal	19,797
Total Operating Expenses	268,909
Net Operating Income	63,277

X. *REVENUE REQUIREMENT*

Applying the specific findings and conclusions reached herein and further adopting as reasonable all Staff adjustments not specifically addressed herein, the following calculation of SWB's Revenue Requirement is deemed to be reasonable and adopted for purposes of this rate case.

REVENUE REQUIREMENT CALCULATION

	DESCRIPTION		ADJUSTED AMOUNT (000's Omitted) $
1.	Total Rate Base		731,866
2.	Operating Revenues		332,186
3.	Operating Expenses		268,909
4.	Net Operating Income		63,277
5.	Realized Return on Rate Base (%)	8.65	
6.	Required Return on Rate Base (%)	9.98	
7.	Required Earnings on Rate Base		73,040
8.	Revenue Deficiency		9,763
9.	Gross Conversion Factor	1.9802	
10.	Gross Revenue Deficiency		19,333

11. Revenue Requirement (Line 2 + Line 10)	351,519

XI. *QUALITY OF SERVICE*

Staff conducted a field audit of SWB's facilities and operations to determine whether its service was meeting the quality standards set by our *General Service Rules* and *Special Rules-Telephone Companies.* As a result of that audit, Staff determined that SWB was furnishing and maintaining adequate telephone service in all of its service areas. The Company's maintenance performance in keeping all plant facilities and equipment in a good state of repair meets the maintenance service objectives directed by the Commission in Special Rule 17.0. We accept Staff's finding.

Staff also expressed its concern over the manner in which SWB presently interprets and applies Rule 6.0 of the Commission's *Special Rules-Telephone Companies* with regard to the construction of new service line extensions. We too share Staff's concern, however, the present docket does not appear to be the most appropriate vehicle for addressing this issue. We note that this particular issue is presently being addressed on a generic basis in Docket No. 85-054-R. Therefore, due to the pendency of this issue in Docket No. 85-054-R we decline to address this matter herein.

XII. *DEMAND ANALYSIS*

The theory of repression is founded upon a simple economic proposition: As the price of a service increases, other things being equal, the quantity of the service de-

manded decreases. The extent of the demand decrease in relation to the price increase is referred to as the elasticity of demand for the service. A service with a high elasticity of demand will have a larger demand decrease for each dollar of price increase than will a service having a lower elasticity of demand.

Mr. Thomas Douglas of SWB and Mr. Paul Waits of the Staff were the only two witnesses to file testimony addressing the issue of repression. SWB presented direct and rebuttal testimony of Mr. Thomas Douglas which provided repression estimates for the following services which are subject to a rate increase in the present docket. The services are as follows:

1. Public Coin Telephone Service
2. Operator Services
   a. Line Status Verification (LSV)
   b. Busy Interrupt (BI)
3. Message Telecommunications Service

SWB requests that this Commission utilize a repression adjustment to inflate the amount of any rate increase awarded. The basis for this request is SWB's claim that the increased cost of the service will cause a decrease in demand for the service and, therefore, without a repression adjustment the proposed tariffs will not generate the revenues estimated. SWB contends this adjustment should be made for the above referenced three services for which they submitted demand analysis studies.

Although Staff did not submit demand analysis studies, Staff witness Mr. Waits did present testimony regarding the validity of the proposed adjustment and the

studies on which they were based. Mr. Waits conceded that SWB's studies were not only the best available in the record of this Docket, but the only studies available in the record. However, he testified that SWB's studies failed to consider certain factors, including "overpays" associated with coin rates and utilized data from other states assuming that the users from that state are directly representative of the customers in Arkansas. Mr. Waits further states that "Though repression is "known", being the best available measure does not alone compel this Commission to consider repression a "measureable" change for the purpose of further inflating proposed rate increases." (T. 768).

As stated previously, the standard for considering adjustments is set forth in Ark. Stat. Ann. § 73-217.5 (Cum Supp. 1983) which provides, in part, " . . . that the Commission shall also permit adjustments to any test year so utilized to reflect the effects . . . of any and all changes in circumstances which may occur within 12 months after the end of such test year where such changes are both reasonably known and measureable."

Based upon the guidelines set forth in this statute, we must accept Staff's position and reject the repression adjustment proposed by SWB. In accord with our previous decisions, we find that while the theory of repression is "known" we cannot agree with the proposition that its effects can be measured with the degree of accuracy required by statute to qualify as both a reasonably known and measurable change.

XIII. *RATE DESIGN*

Two witnesses presented testimony regarding rate and tariff design. SWB presented testimony by Mr. Larry Walther, Division Staff Manager-Rates and Separations. Staff presented testimony by Mr. Paul Waits, Commission Staff Rate Analyst.

A. *Impact of Federal Court Depreciation Order*

SWB's testimony was filed on July 11, 1984. On August 3, 1984, shortly after the testimony was filed, this Commission implemented rate changes in accordance with the decision of the United States Court of Appeals for the Eighth Circuit. The federal injunction directed this Commission to grant SWB recovery of $11,256,000 in additional revenue requirements. SWB had originally proposed to recover the revenue deficiency of $11,256,000 by increasing only local exchange service. We denied the Company's request. We subsequently directed that the revenue dificiency found by the federal court to be recovered by increasing rates for Directory Assistance, coin telephone service, local exchange service, intraLATA MTS/WATS, and access service. Order No. 50, Docket No. 83-045-U.

We ordered that charges for local calls from public and semi-public telephone service be increased from 10¢ to 20¢ per call. We exempted from this increase coin telephones that were not equipped to provide dial tone first and coin telephones that were located at: "(1) nursing homes, (2) public elementary or secondary schools, (3) city, county, state or Veteran's Administration hospitals, (4) government subsidized low income public housing projects." (T. 609, 741).

Coin telephones that are equipped for dial tone first allow a caller to reach an operator in an emergency without depositing coins. Callers using dial tone first coin telephones can also reach directory assistance, an 800 number (in-WATS), or a 911 special emergency number without having to deposit any money.

We also directed in Order No. 50, Docket No. 83-045-U ~~that~~ Directory Assistance (DA) charges be increased in accordance with the plan filed by the Company in Docket No. 84-165-U. That plan was a two-level directory assistance charging plan. The first level merely increased the existing DA plan; the second level imposed a higher charge for excessive DA calls. The proposal retained our previously approved three-call allowance. As to the plan's first level, the Company proposed that direct-dialed DA calls in excess of the three-call allowance be charged at 20¢ per call instead of 10¢. In the plan's second level, the Company proposed that direct-dialed calls in excess of 25 calls per line per month and operator handled calls receive a charge of 40¢ per call. We approved this plan on August 3, 1984.

To recover the balance of the revenue deficiency determined by the federal court, we granted a 3.76% surcharge to be placed on local exchange service, intraLATA MS/WATS and access service. We expressly made this surcharge applicable only to SWB's customers.

B. *Coin Telephone*

SWB proposed to increase the rate for local telephone calls from 20¢ to 25¢ except for calls placed from public coin telephones at certain locations, i.e., nursing homes, public elementary/secondary schools, city, county, state or Veteran's Administration hospitals, and government

subsidized low income public housing projects, which would remain at 10¢. SWB witness, Russell H. Ewing, SWB Division Staff Manager for cost studies, contended on pages 6 and 7 of his prepared testimony, that SWB's 1983 Public Telephone Cost Study, which was used to determine the average annual cost based on historical data of providing local service from public telephones of all types, i.e., public coin, public coinless, and semi-public coin, shows that if the 25¢ deposit rate had been in effect during 1983, that the costs of providing public telephone service would had been greater than the revenue collected, but that the shortfall improved from a negative $7,067,578 at 10¢ the rate to a negative $4,682,754 at the proposed 25¢ deposit rate. Mr. Ewing contended that the cost per call under the proposed 25¢ deposit rate was 34¢ per call.

Mr. Ewing also cited the Commission's directive in Docket No. U-2700, which suggested the need for a cost study in order to determine the average cost per coin telephone call using jurisdictional separations. Mr. Ewing's separated study indicated a revenue shortfall of a negative $3,861,112 at the 10¢ rate and negative $1,520,032 at the proposed 25¢ rate.

With the exception of the inclusion of repression in calling volumes, which was utilized by SWB in calculating the revenue affect of a rate change in coin telephone from 20¢ to 25¢, the Commission's Staff voiced no objection to the change, citing the exceptions to an increase which was built into the increase from 10¢ to 20¢, as a result of the Commission's Order No. 50 in Docket No. 83-045-U, which determined the manner in which SWB was entitled to collect additional annual revenues of $11,256,223 from intrastate services.

When this Commission issued Order No. 50 in Docket No. 83-045-U we made our position on coin telephone quite clear on pages 4 and 5 of Order No. 50 as follows:

> The Commission has recognized that factors other than cost of service should be considered when determining the price of a call from a coin telephone. The public benefits from cheap access to the telephone network via coin telephones. The exceptions contained in the plan adopted herein *preserve that public benefit in part.* In addition our adoption of a lifeline rate plan in Order No. 41 in this docket mitigates the effect of the higher coin rate on a portion of the low income population. *In spite of these reasons, we raise the coin phone rate under protest* and only because we feel we have little choice in light of the increases already placed on other categories of service in this Docket. [Emphasis added]

In addition to the views of the Commission expressed in Order No. 50 of Docket No. 83-045-U, this Commission has, in SWB's last general rate case, emphasized the need for the consideration of other factors other than cost studies in setting Commission policy with regard to public access to coin telephone, by quoting at length former Chairman Norton and the 1981 Commission because, as we stated in Docket 83-045-U, those "words of wisdom ring with validity, passion, and elegance that this Commission will not attempt to duplicate." As they said:

> Pay phones are first and foremost a public convenience. Their availability is subsidized by all of us on the understanding that any of us may have a need for them at any given time. The principle is not dissimilar from that which underlies mutual insurance programs. Furthermore, because of the unique, two-way nature of the telephone utility in contrast to simple delivery utilities, those on the receiving end of pay phone initiated calls also receive some benefit from

their availability. Again, it is to be expected that any customer may at any time need to be the recipient, as well as the sender, of a pay phone call, so that the insurance principle applies at both ends of the transmission.

It is impossible for us to say, therefore, that the basic exchange ratepayer realizes nothing from the availability of pay phones. The question on the present record is whether he realizes a dollar's worth in a year.

We now enter the much-decried realm of value-of-service ratemaking. Although severely criticized by many cost-of-service adherents, value of service occurs to us to be the ultimate *raison d'etre* for public utility regulation. Besides, we have seen above how reliable "cost" is. In the final analysis, the destination of regulation is the public interest; "cost" and "value" are only signs along the way.

The telephone network today is a vast planetary spiderweb of connections among earthlings. Access to this complex will surely be a subject of vigorous competition in years to come to our communications technology advances, by leaps and bounds, beyond simple voice transmission. Even now, however, there are few among us who can deny that at least once in their lives ready access to a telephone was priceless. It may have been business or it may have been romance; . . . it may have been your mother, or it may have been your children. The rest of the world is in a telephone booth, and getting at it cheaply and quickly from thousands of random locations is worth a dollar a year at least. Until that situation changes, pay phones will remain a dime."

Therefore, this Commission, at this time, will resist the temptation to conveniently raise coin telephone rates from 20¢ to 25¢ and will reject the proposal of SWB and Staff to raise the price of a call to 25¢.

C. *Operator Assistance*

SWB is also proposing to charge for local or intra-LATA operator assisted line status verification and busy interrupt calls. Line status verification is the term used to describe the procedure which enables a customer to obtain operator assistance to determine the condition of a line. An example is a customer who requests an operator to verify a busy signal on a telephone line they are trying to call. SWB proposes a charge of $1.40 per call for this service.

Busy interrupt is a service where a calling party may ask for operator assistance to interrupt a call in progress to determine whether the called party will allow the completion of the new call. Simply stated, it is a procedure whereby an operator interrupts and asks a party on the line if they would disconnect their current call so that they may receive a call from another party. The Company is proposing a $2.15 charge for this operator service.

Historically, the Company has provided line status verification and busy interrupt to its customers at no separately identified charge. SWB must now pay AT&T for their operators performing these services for a SWB customer. Staff agrees with the proposed rates for operator services and finds that the rates are reasonable.

SWB proposes applying service charges for the following operator assisted local calls:

Dial calling card—35¢

Operator station-to-station—90¢

Person-to-person—$2.50

The operator service charges SWB is proposing for local calls are the same as those that are applied today for operator assistance on intraLATA long distance calls. The operator function is the same for both types of calls. The proposal results in the same charges being applied to all customers who use operator assisted service. We have directed that charges not be applied to those customers whose physical or visual handicaps prevent them from dialing the call direct.

The Commission's Staff adopts the above SWB proposals, which the Staff believes are an appropriate application of "unbundling" of services, i.e., services which are separated out from other local exchange charges so that the general body of telephone subscribers will not have to subsidize the users of these discretionary operator services. The Commission finds that these proposed rates for operator services are reasonable and adopts the annual revenue impact as found by Staff Witness Waits in his supplemental and surrebuttal testimony to be in the amount of $2,291,000.

D. *Service Connection Charges*

The Company proposes to change the service connection charge plan by creating a Dual Element service connection charge plan. The Dual Element plan divides service connection charges into two categories: (1) a Service and Equipment (S&E) charge and (2) a Premises Work Charge. The S&E charge is a product or service specific rate. This element includes costs related to the service order and central office access work requires when a customer requests new service or a change in existing service.

The Premises Work Charge is a time sensitive charge that includes the cost associated with the trip to the customer's premises and the labor and material cost associated with work at that location. Premises work by the Company is optional to the customer, since they can make other arrangements for much of this work. The Premises Work Charge is divided into 15-minute increments. There are three schedules for these incremental charges. Schedule 1 is applicable to work performed Monday through Friday between 8 a.m. and 5 p.m. Schedule 2 is applicable to work performed Monday through Friday at hours other than Schedule 1 and all day Saturday for other than Company reasons. Schedule 3 is applicable to work performed on Sundays and holidays for other than Company reasons.

The Dual Element plan is cost specific and varies in accordance with the cost caused and work requested by each customer. For example, using the existing service connection charge plan, the charge is the same to connect a residence access line, change a telephone number or change the grade of telephone service. Under the proposed Dual Element plan, there will be a different charge for each of these activities, which reflects a differing degree of work required in each situation.

Staff agrees with the proposed Dual Element service connection plan, however, Staff disagrees with several S&E charge levels proposed by SWB. A comparison of each of the non-recurring service and equipment charges proposed by SWB to recover costs associated with service ordering/billing and central office access/modification are listed below with the corresponding staff proposed charges as well as the proposed charges as outlined in the prepared testimony of Staff Witness Paul Waits as follows:

PRODUCT/SERVICE	SWB PROPOSAL	STAFF PROPOSAL	CURRENT CHARGE
Central Office Access Residence	$59.70	$45.00	$51.85
Custom Calling Service			
Residence	$14.50	$10.00	$5.00
Business	$22.50	$20.00	$10.00
Change Grade/Type of Service Residence	$12.00	$ 8.00	$51.85
Change to/from Touch-Tone Residence	$12.00	$ 8.00	$39.25
Number Changes/Change Class of Service Business	$23.75	$28.75	$48.05

SWB contends that its S&E charge proposals are based on incremental costs studies that allocate investment and expenses to determine the cost to initiate and terminate a specific service. However, the Commission adopts the Staff proposed charges in recognition of rate making criteria that overshadows the requirement that these none-recurring charges be strictly based on allocated cost studies. The Commission adopts the rationale contained in the prepared testimony of Staff Witness Paul Waits in which he discusses the importance of reducing the non-recurring charge for central office access as follows:

> . . . the changes in SWB's proposed S&E charges that I am recommending recognize "ratemaking" criteria that can outweigh or mitigate the requirement that these non-recurring charges be based strictly upon allocated cost studies. The most important example of this is the S&E charge proposed for central office access. I have proposed a reduction in the non-recurring charge for central office access in order to promote *universal service* for the relatively mobile telephone subscribers of SWB. The reasoning behind this proposal clearly parallels the historic reasoning

underlying the 'residual' pricing of local telephone service. *Overall, the amended charges above all represent an intent to structure these non-recurring charges in a way that minimizes, directly or indirectly, the price of basic telephone service.*" [Emphasis added]. (T. 745)

For the above reasons, the Commission adopts Staff witness Waits' specific charge levels and his calculation of the Annual Revenue impact of the "unbundling" of these service and equipment charges to be in the amount of $2,091,000. (T. 765).

E. *Optional Wire Maintenance Plan*

SWB also seeks to introduce an Optional Wire Maintenance plan for simple inside wiring. Under the proposal a customer will have three options. A customer may: (1) elect to have SWB maintain their simple premises wire for a 30¢ monthly rate per line; (2) have the Company provide maintenance on an "as occurs" basis and pay Premises Work Charges for each occurrence, or (3) performs his or her own maintenance.

As explained by Staff Witness Waits, there are no non-recurring charges upon implementation of the plan, and there are no non-recurring charge if a customer elects to discontinue paying the 30¢ per month. However, if a customer who elected not to pay the 30¢ inside wire maintenance fee, subsequently wants to be covered by the plan, a non-recurring charge of $7.75 would apply.

At the present time, the expense associated with the maintenance of inside wire is recovered from the general body of ratepayers. The Company's plan will allow re-

covery for the cost of maintaining the wire from those customers who elect for SWB to maintain simple wire at their premises.

Staff determined it to be reasonable that the owners of inside wire should be responsible for that wire's maintenance and that SWB's Optional Inside Wire maintenance plan was appropriate because it recognized the ability of customers to provide and maintain their own inside wire. Staff incorporated the Company's proposed optional inside wire maintenance plan into its overall rate proposal to collect the revenue deficiency calculated by Staff. We approve this plan.

Staff also recommended that SWB make its customers cognizant of their options by use of a bill insert. SWB has agreed to prepare a bill insert explaining to its customers the options that are available for the maintenance of inside wire and the action required of the customer in order to advise SWB of the customer's choice. We recommend the bill insert instruct the customer that he/she should return the form when payment of his telephone bill is tendered and that failure to return the form to SWB will result in automatic coverage under the plan.

The Commission adopts Staff Witness Waits' calculation of the annual revenue impact of this plan to be in the amount of $1,865,000. (T. 765).

F. *Miscellaneous Services*

SWB also proposed increases in certain tariffs found in Section 19 of the general exchange tariff. The services affected include telephone answering services, public coin telephone equipment, group alerting and dispatching serv-

ice, as well as some other miscellaneous offerings. The revenue associated with these miscellaneous charges is $27,000. Staff concurred with these proposed tariff changes and we accept their recommendation.

G. *MTS/WATS*

In SWB's initial filing it urged and requested that the Arkansas intraLATA Toll Pool (AITP) seek a rate increase in a separate proceeding. However, Staff recommended that we direct the AITP to raise intraLATA MTS and WATS rates in a uniform manner in the present proceeding. Staff's proposal was offered in lieu of an intraLATA toll increase to be determined on a SWB Company specific basis. Staff stated that its recommendation was based on the historical manner in which intrastate toll rates have been established in the past. Staff, through its recommendation, further seeks to maintain uniform intraLATA Toll Pool rates in order to prevent possible customer confusion and to maintain the status quo where possible as directed in Docket No. 83-042-U. We agree.

Initially Staff proposed a rate increase designed to earn a return on intraLATA toll investment equal to the overall rate of return proposed by Staff for SWB. The overall rate of return proposed by Staff was 9.83%. However, after receiving updated information from the Pool Administrator, Staff revised its recommendation and recommended an increase in intraLATA toll to the 10.08% rate of return used by SWB in 1983 for intrastate toll settlements. The net revenue increase to SWB of raising the pool rate of return to 10.08% and of removing the

3.76% surcharge on SWB originating intraLATA toll revenues is $6,165,000. The AITP and General Telephone of the Southwest (GTSW) both concur with Staff's recommendation. We find Staff's proposal to be reasonable and, therefore, hereby direct the AITP to file schedules designed to increase rates as per Staff's recommendation thereby increasing intraLATA toll revenues by $13,377,450. The increase shall be derived in accordance with and as proposed by Staff witness Waits in his Supplemental Exhibits PW-1 and PW-2.

Staff also recommended eliminating the 3.76% surcharge on SWB's intraLATA MTS and WATS services that was ordered by the Commission in Order No. 50 of Docket No. 83-045.U. In furtherance of the desire to maintain uniform intrastate toll rates we concur with the elimination of the 3.76% SWB specific intraLATA toll surcharge. However, all other "surcharge" directives contained in Order No. 50 of Docket No. 83-045-U shall remain undisturbed.

The Commission fully intends to continue before the United States Supreme Court a vigorous defense of its sovereign right to establish intrastate depreciation rates. In the event the Commission ultimately prevails on this issue, SWB will be required to make appropriate refunds to compensate for the excessive depreciation rates it has been allowed by the federal courts. The exact methodology for calculating and implementing such potential refunds will be determined by the Commission only after and in the event we ultimately prevail before the Supreme Court. In the interim SWB should continue to maintain whatever accounting records as are necessary in order to

preserve for the Commission a full range of potential refund options.

H. *Access Charges*

In response to a motion filed by Staff, the Attorney General, and SWB we transferred consideration of access charges to the Generic Docket No. 83-042-U. A generic order is to be issued in that docket which will encompass SWB's access tariffs.

Staff initially proposed a change in the 3.76% surcharge that resulted from Order No. 50 in Docket No. 83-045-U that was applied to access service provided by SWB. That proposal would have increased the 3.76% surcharge to 4.5%. After receiving updated information, Staff withdrew this proposal. (T. 763). Staff, therefore, proposed no changes to SWB access surcharge. We approve of this withdrawal.

I. *Local Exchange Services*

1. *Hunting and Conditioning*

SWB proposes to introduce two new charges for hunting and conditioning. Hunting (also known as rotary) is a feature which allows a call directed to an exchange line to be automatically forwarded to another exchange line when the first one is busy. The feature is available to both residence and business customers who have more than one exchange line. SWB proposes to begin charging 50¢ a month per line for each line having this capability.

Conditioning is a feature which provides for improved transmission capabilities on standard voice grade

basic exchange lines. The Company proposes two types of conditioning charges. The first is used primarily when customer premise equipment (CPE) switching systems are involved. The second is used when data terminals are associated with exchange lines. The SWB proposes to implement monthly charges of $3.00 and $2.00 respectively for these features which are available to both business and residence.

Staff concurs with the charges for hunting and conditioning and has determined that the proposed charges are reasonable. We approve the proposed charges for hunting and conditioning.

2. *Multi-line/PBX Trunks*

SWB also proposed to consolidate PBX trunk and multi-line rates with the combined PBX/Multi-line rate being equal to 120% of the flat rate single line business line (1FB). It is proposing one rate applicable to both multi-line and PBX trunks because it does not have the capability of administering two separate rates since it no longer provides customer premise equipment (CPE) in conjunction with providing basic exchange service. Staff concurs with the proposed consolidation.

The combining of multi-line and PBX trunks into one class of service will require that a change be made in another tariff section. The General Exchange Tariff currently provides for Touch-Tone service to be charged at a separate rate for PBX trunks. The consolidation of PBX trunks and multi-line rates necessitate the combining of the business line and PBX trunk Touch-Tone rates into one new rate for Touch-Tone service. This consolidation

produces essentially the same overall revenue that is produced today by the two separate rates in the General Exchange Tariffs. Staff concurs with the combination of the business line and PBX trunk Touch-Tone rates into a single business rate for Touch-Tone service. We approve the proposed consolidation of multi-line PBX rates and the associated Touch-Tone business line rate.

3. *Semi-public Service*

SWB proposes that the semi-public coin telephone line rate be raised to equal the measured/message business line rate. Currently semi-public service rates are less than the measured/message business rates. For all practical purposes the access line furnished to both of these usage sensitive services is the same. Staff concurs with SWB's proposal to move the semi-public rate to parity with the flat rate component of message/measured business service. Under the Staff proposal this would equate to the current business measured rate relationship of 59% of the 1FB, and not the 65% as proposed by SWB. We approve the parity proposal with the rate relationship for both semi-public and message measured business rates at 59% of the 1FB rate.

The Company proposes to reduce the basic relationship between residence 1-party flat rate and business 1-party flat rate from 210% to 190%. Staff disagrees with the Company's proposal to change the relationship of the 1FB to the 1FR. Staff proposed that the increase in 1FB rates be 200% of the increase in the 1FR rates. We find Staff's proposal reasonable and, therefore, adopt same.

Staff also proposes another change in the local exchange matrix. Staff is concerned that the current local

exchange matrix increases the absolute difference among the rate groups and exaggerates the value of service principal used to justify these rate groupings. Staff preposes a summation by rate class of all rate groups before applying the matrix for purposes of calculating a constant or absolute dollar increase per rate class for all rate groups. Staff's proposal would lessen the disparity among rate groups, and would eliminate, according to Staff, customer confusion regarding the amount of increases. We concur with the Staff proposal.

8. *Toll Recording Trunks*

Staff proposes the introduction of a PBX trunk multiline rate for the dial "8", toll recording trunks provided by SWB to hotels and motels. These services are currently provided without charge. Charges for this service have been introduced in other state jurisdictions served by SWB. Staff introduced this charge to mitigate increases to basic local service. We approve Staff's proposal.

4. *Message/Measured Business Allowance*

SWB also proposed to eliminate the allowances associated with message/measured business service so that usage would not be packaged in with the rate for any business exchange service. Staff concurs in eliminating the usage allowance. We approve of this change.

5. *Extended Area Service (EAS)*

SWB proposes to increase EAS rates by the overall rate case percentage increase in revenues. Under the pro-

posal each residence one-party flat rate EAS increment would be increased. The remaining EAS increments were developed according to the methodology approved by the Commission in Docket No. 83-045-U. Staff agrees with the proposed EAS increase, but recommends that the Staff's rate increase percentage and the Staff's recommenced local exchange matrix be used for calculating the EAS increments. We accept Staff's recommendation.

6. *Centrex Service*

SWB proposes a rate change in the local exchange access portion of the Centrex II C.O. station line rate and the Centrex C.O. dormitory station line rate. This change is caused by the proposed rate change in the Local Exchange Tariff and will maintain the rate relationship between the Local Exchange Tariff and the applicable Centrex C.O. tariffs. Staff agrees with the proposed change to maintain this rate relationship and we concur.

7. *Basic Exchange Rates*

SWB proposes to recover the remainder of its revenue deficiencies from basic exchange service. It determined the amount to be recovered from basic exchange service after repricing all other services. We agree and direct SWB to design its rates in accordance with this residual basic exchange pricing philosopy. In addition, it proposed a change in the local exchange matrix used in the development of local exchange service rates.

The local exchange matrix is a set of percentage relationships that determine rate relationships between classes of exchange telephone service, as well as rate groups. The

matrix concept was developed in Docket No. U-3025 and recently restated in Docket No. 83-045-U. (Walther Exhibit No. 3). The matrix is used in establishing all residence and business rates.

IT IS, THEREFORE, ORDERED:

1. The tariffs filed by the Company are disapproved.

2. That all Staff adjustments not explicitly rejected or modified are hereby adopted.

3. The Company is hereby authorized to file rates and tariffs designed to collect a total revenue requirement in the amount of $351,519,000. Said rates and tariffs shall conform to the provisions of this Order. The Company is further directed to provide a tariff revenue summary showing the revenue levels to be produced by all categories of service.

BY ORDER OF THE COMMISSION

This 3rd day of May, 1985.

/s/ Robert Johnston
Dr. Robert E. Johnson, Chairman

/s/ James W. Daniel
James W. Daniel, Commissioner

/s/ Patricia S. Qualls
Patricia S. Qualls, Commissioner

/s/ Corinne B. King
Corrine B. King
Secretary of the Commission

APPENDIX E

28.1 Listing

Below are listed the subsidiaries and affiliates of Southwestern Bell Corporation (SBC). Southwestern Bell Telephone Company is a direct subsidiary of SBC as are each of the other listed companies.

SBC Asset Management, Inc.

SBC Corporate Services, Inc.

SBC Administrative Services, Inc.

Southwestern Bell Mobile Systems, Inc.

Southwestern Bell Telecommunications, Inc.

Southwestern Bell Corporate-Washington, Inc.

Southwestern Bell Foundation

Southwestern Bell Capital Corporation

Southwestern Bell Publications, Inc.

Metromedia Paging Services, Inc.

Southwestern Bell Printing Company

Southwestern Bell Telephone Company

Below are listed the subsidiaries and affiliates of Southwestern Bell Company Company (SWBT). These are all direct subsidiaries of SWBT.

SWBT Co. of Arkansas

Arkansas Bell Telephone Co.

SWBT Co. (OK.)

Oklahoma Bell Telephone Co.

Kansas Bell Telephone Co.

Missouri Bell Telephone Co.

Texas Bell Telephone Co.

Texas Bell Communications Co.

Southwestern Redevelopment Corp.

Southwestern Redevelopment Corp. II

Bell Communications Research Inc. (1/7 ownership)